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AUDITOR'S COMPLIANCE SUPPLEMENT

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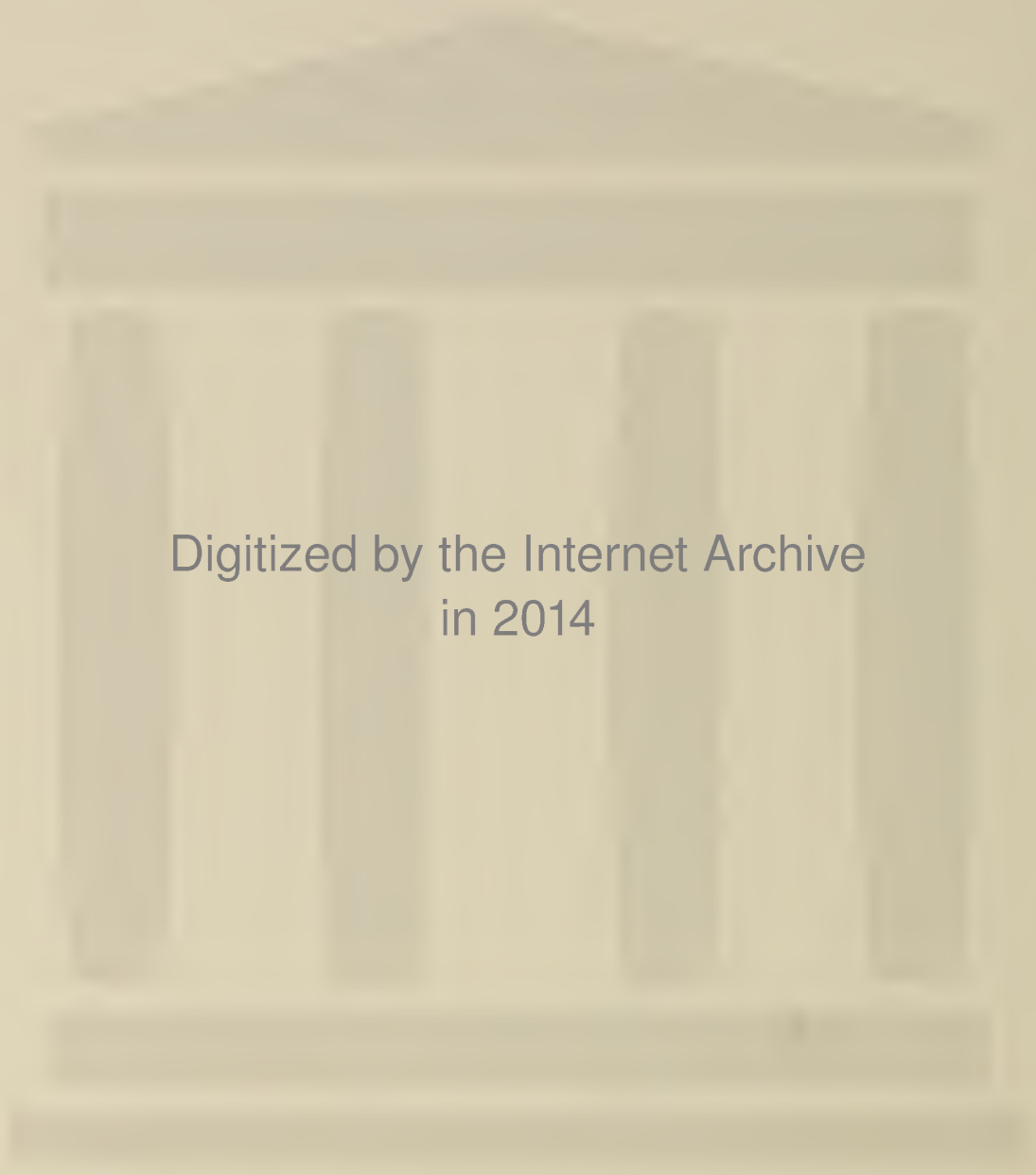

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UNIFORM FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

AUDITOR'S COMPLIANCE SUPPLEMENT

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Approved by: Philmore Anderson III. State Purchasing Agent

Introduction

When an independent auditor is engaged to audit the Uniform Financial Statements, the financial audit must be conducted and reported in accordance with Generally Accepted Government Auditing Standards (GAGAS). Government Auditing Standards (commonly referred to as the "Yellow Book") have been promulgated by the Comptroller General of the United States General Accounting Office (GAO). The guidance that follows has been adapted for use in audits of contractors contracting with the Commonwealth and excerpted from the "Yellow Book" and the GAO office policy publication, "Assessing Compliance With Applicable Laws and Regulations." GAO's standards require that all audits include an assessment of compliance with relevant laws and regulations that are material to the engagement objectives. For financial statement audits, the standard provides the following:

- Auditors should follow up on known material findings and recommendations from previous audits.
- Auditors should design the audit to provide reasonable assurance of detecting irregularities that are material to the financial statements.
- Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from direct and material illegal acts.
- Auditor's should be aware of the possibility that indirect illegal acts may have occurred. If specific information comes to the auditor's attention that provides evidence concerning the existence of possible illegal acts that could have material indirect effect on the financial statements, the auditor's should apply audit procedures specifically directed to ascertaining whether an illegal act has occurred.
- Auditor's should design the audit to provide reasonable assurance of detecting material misstatements resulting from noncompliance with provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts. If specific information comes to the auditors' attention that provides evidence of possible noncompliance that could have a material direct effect on the financial statements, auditors should apply audit procedures specifically directed to ascertaining whether that noncompliance has occurred.
- In addition, the audit of the UFR requires the auditor to employ certain reporting and fieldwork standards of GAGAS for performance audits when testing and reporting on contract compliance (see paragraph 2.2 of 1994 "Yellow Book").

The "Yellow Book" also requires that financial audits be performed in accordance with the fieldwork and reporting standards prescribed by the American Institute of Certified Public Accountants (AICPA). AICPA has issued a series of Statements on Auditing Standards (SAS), and the following are particularly applicable to detecting and reporting noncompliance with laws and regulations on financial and certain aspects of performance audits:

- Compliance Auditing Applicable to Government Entities and Other Recipients of Governmental Financial Assistance (SAS 74);

- Consideration of the Internal Control Structure in a Financial Statement Audit (SAS 78);
- Illegal Acts by Clients (SAS 54); and
- The Auditor's Responsibilities to Detect and Report Errors and Irregularities (SAS 53);
- Omnibus Statement on Auditing Standards 1983 (SAS 45) AU Section 334, Related Parties and Au Section 9334 Related Parties: Auditing Interpretations of Section AU 334;
- Audit Risk and Materiality in Conducting an audit (SAS 47).

Audits of contractors for Single Audit purposes carry additional requirements that the auditor must be aware of to conduct the audit. These requirements are noted in the Executive Office of The President, Office of Management and Budget publication, OMB Circular A-133 "Audits of States, Local Governments and Non-Profit Organizations." In, addition the OMB Circular A-133 Provisional Compliance Supplement contains specific guidance for conducting audits in accordance with OMB Circular A-133.

General Requirements

Audits must be properly planned and include steps to provide reasonable assurance-**not absolute or complete**-that material instances of noncompliance that directly relate to the engagement's objective(s) are detected and reported. Auditors should not presume the contractor is in compliance or not in compliance but should do sufficient testing to provide reasonable assurance that noncompliance, which is individually or in the aggregate material, would have been identified.

Sufficient steps must be performed to detect major noncompliance without spending an unreasonable amount of resources on those steps. Too much audit effort would waste valuable resources needed elsewhere, while not enough work risks instances of material noncompliance going undetected.

The standard does not expect auditors to uncover every impropriety; instead, it requires reasonable tests to assure detection of major noncompliance (errors, fraud, illegal acts, or irregularities) and abuse.

The "Yellow Book" requires auditors to perform audit steps as follows:

1. Determine if engagement objectives require that tests of compliance with laws and regulations be performed;
2. Identify laws and regulations that apply to the entity being audited and that are relevant to engagement objectives;
3. Assess the risk that noncompliance with these laws and regulations could significantly affect the program operations or financial statements being audited;
4. Consider whether internal controls deter or help detect noncompliance;
5. Design work steps to reasonably assure the (1) entity's compliance with relevant laws and regulations and (2) detection of errors, irregularities, abuse, or illegal acts that could significantly affect the engagement objectives;
6. Exercise appropriate caution in investigating illegal acts so as not to interfere with potential future investigations and/or legal proceedings;

7. Promptly prepare an audit report that includes irregularities, illegal acts and other material or significant noncompliance (for; example violations of contract provisions) and
8. In some circumstances, auditors should report irregularities and illegal acts directly to parties external to the audited entity.

Terms Defined

Noncompliance with laws and regulations includes both intentional and unintentional acts as well as a variety of other terms, such as "fraud," "abuse," "errors," and "irregularities," and these and other terms are defined as follows:

Abuse is distinguished from noncompliance in that abusive conditions may not directly violate laws or regulations. Abusive activities may be within the letter of the laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior. This would include furnishing excessive services to beneficiaries; or performing what may be considered improper practices, none of which involves noncompliance with laws and regulations.

Civil act - An illegal act for which penalties that do not include incarceration are available for a statutory violation. Penalties may include monetary payments and corrective actions.

Criminal act - An illegal act for which incarceration, as well as other penalties, is available if the government obtains a guilty verdict.

Error - Unintentional noncompliance with applicable laws and regulations and/or misstatement or omission of amounts or disclosures in financial statements.

Fraud - Action that violates a fraud-related statute of the federal or state government.

Illegal act - Failure to follow requirements of laws or implementing regulations, including intentional and unintentional noncompliance and criminal acts.

Irregularities - Intentional noncompliance with applicable laws and regulations and/or misstatements or omissions of amounts or disclosures in financial statements.

Identifying Laws and Regulations

During the early phase of an engagement, auditors should identify the laws and regulations that apply to the engagement subject area and might significantly affect engagement objectives.

The first step is to identify general laws and regulations applicable to the subject of the engagement. For example, when auditing the contractor's Uniform Financial Statements, the laws and regulations associated with the organization's charitable purpose and delivery of social services will apply.

The second step is to identify more specific laws and regulations applicable to the contractor's activity. For example, the contract that is executed between the contractor and the Commonwealth's purchasing agency is governed by the incorporation of general conditions, procurement regulations and contracting requirements.

The third step is to identify those provisions of laws, regulations and policies relating directly to the engagement objectives. For example, violation of contract provisions or regulations that govern reimbursement for services delivered by the contractor could have a material effect on the financial statements.

Sources of information that auditors can use to identify applicable laws and regulations include:

- Federal and State employment and labor laws.
- Internal Revenue Code, Massachusetts Department of Revenue and Division of Employment and Training laws.
- Commonwealth Terms and Conditions for Human and Social Services.
- Code of Massachusetts Regulations (available from State Bookstore).
- Code of Federal Regulations (available from Federal Bookstore).
- State agency contracting requirements (contained in purchasing agency contracts with the contractor) and in Secretariat guidance furnished to state purchasing agencies.
- Division of Purchased Services Contract Instructions and Forms.
- Commonwealth of Massachusetts Policies and Procedures Handbook for Human and Social Services.

Materiality/Significance and Sensitivity

The auditor should consider materiality and/or significance and sensitivity in planning the audit and in selecting the methodology and designing audit tests and procedures, as well as in deciding whether a matter requires disclosure in an audit report.

Materiality concerns the magnitude of omissions or misstatements of accounting information that, in the light of circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by omissions or misstatements. Materiality judgments involve both quantitative and qualitative considerations. One of the criteria to be considered in determining materiality includes the monetary value of the item. Qualitative factors include, but are not limited to, the cumulative effect and impact of immaterial items, the objectives of the work undertaken, and the use of the reported information by the users or groups of users of the information.

Significance concerns the importance, in relation to the audit objectives, of items, events, information, matters or problems the auditor identifies.

Sensitivity involves how given matters will be perceived by others. It is possible for matters to be both material/significant and sensitive. For example, a former high-level state official used influence to convince a state agency to fund a program operated by a contractor, and for minimal effort the former official was paid a large fee by the contractor.

In determining materiality and/or significance, sensitivity and audit risk. the auditor is expected to consider the following:

a. Amount of revenues and expenditures.
b. Newness of the activity or changes in its condition.
c. Adequacy of internal controls.
d. Results of prior audits.
e. Level and extent of review or other form of independent oversight.
f. Adequacy of the internal controls for ensuring compliance with laws and regulations.
g. Management's adherence to applicable laws and regulations.
h. Audit report users' expectations.
i. Public perceptions and political sensitivity of the areas under audit.
j. Audit requirements.

In government audits the materiality level and/or threshold of acceptable risk may be lower than in similar-type audits in the private sector because of the public accountability of the entity, various legal and regulatory requirements, and the visibility and sensitivity of government-supported programs, activities, and functions.

Generally, the greater the materiality/significance and sensitivity, the greater the degree of required compliance testing.

Determining the Extent of Compliance Testing

Compliance testing should provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and indirect material effect on program operations and the financial statement amounts. This is accomplished by first determining what to test and the degree of testing that is needed. Determining what and how much to test is achieved by completing the previously noted steps, two through five, in the General Requirements section.

These steps and procedures rely upon the professional judgment of the auditor to determine what to test and the degree of testing needed, rather than a series of predetermined audit tests.

Vulnerability Assessment

After laws and regulations that apply to the audited entity have been identified, auditors must assess the risk that noncompliance with these laws and regulations could significantly affect the program operations or financial statements being audited. Once the risk has been determined, the extent of compliance testing to be performed can be established. This is attained by conducting a vulnerability assessment. A vulnerability assessment determines the probability that noncompliance and abuse, which is individually or in aggregate material, could occur and not be prevented or detected in a timely manner by internal controls. The assessment evaluates (1) the inherent risk of a law or regulation to noncompliance and abuse before considering internal controls and (2) whether internal controls will prevent or detect noncompliance and abuse (see table below).

Relationships Between Inherent Risk, Internal Controls, Vulnerability, and Testing Extent

Inherent Risk X	*Internal Controls*	*= Vulnerability/Testing extent*
High	Weak	High
	Adequate	Moderate to high
	Strong	Low to moderate
Moderate	Weak	Moderate to high
	Adequate	Moderate
	Strong	Low
Low	Weak	Low to moderate
	Adequate	Low
	Strong	Very low

The extent of compliance testing is directly related to a contractor's degree of vulnerability. The higher the vulnerability, the more extensive the compliance testing needs to be and vice versa. Thus, even though a contractor may be inherently risky to noncompliance and abuse, strong internal controls can reduce vulnerability to a relatively low level, thereby reducing necessary compliance testing to a relatively low level.

The rationale for performing a vulnerability assessment is that auditors can limit testing and focus on those areas most vulnerable to noncompliance and abuse if internal controls are found to be adequately designed and reliable. This produces a more cost-effective and timely audit.

A. Inherent Risk

Inherent risk is the probability that a law/regulation related to the audit (including the contractor's program operations and financial statements) will not be complied with, or that the area being reviewed is highly susceptible to noncompliance (e.g., pilferage of cash).

Inherent risk is assessed before considering whether the internal controls would prevent or detect such noncompliance or abuse. Assessing inherent risk involves:

- Considering the requirements of applicable laws and regulations;
- Establishing susceptibility to noncompliance;
- Assessing management's commitment to reduce and control noncompliance;
- Determining whether previously identified noncompliance problems have been corrected; and
- Testing transactions.

1. ***Considering Requirements of Laws and Regulations***

The Identifying Laws and Regulations' section of this document discusses how to identify the laws and regulations applicable to the engagement. Some questions to consider are as follows:

- Are the laws and regulations readily identifiable, vague, complex, or contradictory?

  Laws and regulations that are clear, understandable and consistent with other laws and regulations are easier to adhere to and to check compliance than laws and regulations lacking these characteristics.

- Do the laws and regulations relate to a new program, or have they undergone recent or frequent major changes or have they not been enforced?

  Laws and regulations that have recently been implemented or changed or that have not been enforced may be more likely to be violated because people are less familiar with them.

2. ***Susceptibility to Noncompliance***

Auditors should also identify the characteristics that increase the susceptibility to noncompliance. Some questions to consider are as follows:

- Do incentives of noncompliance outweigh the potential penalties?
  If the law or regulation provides a benefit based on need or performance, individuals will have an incentive to overstate their need or performance in order to qualify or to get a larger benefit.
- Is it practicable or reasonable to expect compliance, or are the laws and regulations so burdensome or onerous that noncompliance could reasonably be expected?
- Does the entity have numerous transactions?
  The more transactions there are, the greater the chances that noncompliance could occur due to errors, irregularities, and abuse. Also, a large number of transactions increases the difficulty of detecting noncompliance.
- Have important government-supported activities and programs (e.g., payroll service or client services) been contracted out or delegated to those outside the contractor without ensuring that adequate internal control systems and active monitoring/oversight are in place?
- Does the contractor have a significant amount of assets that are readily marketable (i.e., cash, securities, or drugs) or could be used for personal purposes (i.e., tools, cars, auto repair parts, or computers)?
  Such assets are very susceptible to improper use or theft.
- Are significant benefits of government-supported programs extended to individuals or corporations by contractor officials whose actions are generally not subject to public examinations and evaluations?

Auditors should be alert for and consider any "red flags" or indicators of susceptibility to noncompliance. Any such indicators would vary depending upon

the organizational structure or type of services the contractor delivers. The following are examples of susceptibility indicators that might be identified:

- A pattern of certain contractors bidding against each other or, conversely, certain contractors not bidding against each other;
- Use of government-supported fixed assets and materials on activities that are unrelated to program services;
- A high rate of fines and penalty assessments from taxing authorities;
- Complex transactions;
- Poor records/documentation;
- Activities that are dominated and controlled by a single person or small group without adequate review and oversight;
- Unreasonable explanations to inquiries by auditors;
- Auditee's annoyance at reasonable questions by auditors;
- Employees' refusal to give others custody of records;
- Employees' refusal to take vacations and/or accept promotions; and
- Extravagant life-style of employees.

3. *Management Commitment*

Auditors should consider management's commitment to reduce and control noncompliance. A strong commitment by management to comply is a positive factor in reducing the risk of noncompliance. Some questions to consider are as follows:

- Have problems been repeatedly disclosed in prior audits by your firm or other auditors?
- Does management promptly respond when problems are first identified?
- Are recurring complaints and allegations received by state agencies from the general public or state employees?
- Is management willing to discuss its approach toward compliance?
- Is management knowledgeable of the subject area and potential problems?
- Does management have a constructive attitude, including a willingness to consider innovative approaches?
- Is there a stable management team with continuity and a good reputation, or is there high turnover and/or poor management reputation?

4. *Testing Transactions*

The final step of assessing inherent risk involves testing a limited number of transactions. This testing usually occurs during the stage of an engagement when information is gathered without verification for use in planning the audit (survey stage of government audits). This stage of the engagement is not intended to be a

representative sample of transactions. Rather, the auditor should perform limited work to gain a better understanding of the processes followed by the contractor and to confirm other observations made about inherent risk of noncompliance.

B. Internal Controls

Internal controls consist of policies and procedures used to provide reasonable assurance that goals and objectives are met; resources are adequately safeguarded, efficiently utilized, and reliably accounted for; and laws and regulations are complied with. The independent auditor should consult, review and consider the guidance furnished in the AICPA Standard Consideration of the Internal Control Structure in a Financial Statement Audit (SAS 78) and paragraphs 4.21 through 4.31 of the 1994 Revision of the Yellow Book prior to evaluating internal controls. Evaluating internal controls involves:

- Identifying internal control objectives that management has designed to provide reasonable assurance regarding the achievement of the entities objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with laws and regulations.
- Considering the five components of internal control that should reasonably assure compliance with the requirements of laws, regulations, and program compliance requirements.
- The five components of internal control are applicable to the audit of every entity. The components should be considered in context of:
    * The entity's size.
    * The entity's organization, culture, governance system, ownership or charitable organization characteristics.
    * The nature of the entity's business or non-profit purpose.
    * The entity's methods of transmitting, processing, maintaining, and accessing information.
    * Applicable legal and regulatory requirements.
- Testing control procedures; and
- Identifying needed follow-on actions.

In some instances, auditors may be able to make this evaluation on the basis of recently completed audits or evaluations.

1. Identifying Objectives and Components of Internal Control

The internal control objective is a positive thing that management tries to attain or an adverse condition or negative effect that management is seeking to avoid. For example, the contractor has an objective of not billing the Commonwealth for services to clients who are ineligible for benefits. Auditors should determine what objectives related to the engagement management has established. There is a direct

relationship between objectives and components which represent what is needed to achieve objectives. Internal control components are relevant to the entire entity, or to any of its operating units or functions. Internal controls consist of five interrelated components.

The five interrelated components of internal control and their characteristics that represent what is needed to achieve the objectives of the entity and how to provide reasonable assurance of compliance with laws and regulations are as follows:

Control Environment sets the tone of the organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.

- Sense of conducting operations ethically, as evidenced by a code of conduct or other verbal or written directive.
- Management's positive responsiveness to prior questioned costs and control recommendation.
- Management's respect for and adherence to program compliance requirements.
- Key managers' responsibilities clearly defined.
- Key managers' have adequate knowledge and experience to discharge their responsibilities.
- Staff knowledgeable about compliance requirements and being given responsibility to communicate all instances of noncompliance to management.
- Management's commitment to competence ensures that staff receive adequate training to perform their duties.
- Management's support of adequate information and reporting system.

Risk Assessment is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.

- Program managers and staff understand and have identified key compliance objectives.
- Organizational structure provides identification of risks of noncompliance:
- Key managers have been given responsibility to identify and communicate changes.
- Employees who require close supervision (e.g. inexperienced) are identified.
- Management has identified and assessed complex operations, programs, or projects.
- Management is aware of results of monitoring, audits, and reviews and considers related risk of noncompliance.
- Process established to implement changes in program objectives and procedures.

Control Activities are the policies and procedures that help ensure that management's directives are carried out.

- Operating policies and procedures clearly written and communicated.
- Procedures in place to implement changes in laws, regulations, guidance, and funding agreements affecting Federal awards.
- Management prohibition against intervention or overriding established controls.

- Adequate segregation of duties provided between performance, review, and recordkeeping of a task.
- Computer and program controls should include:
  - Data entry controls, e.g., edit checks.
  - Exception reporting.
  - Access controls.
  - Reviews of input and output data.
  - Computer general controls and security controls.
- Supervision of employees commensurate with their level of competence.
- Personnel with adequate knowledge and experience to discharge responsibilities.
- Equipment, inventories, cash, and other assets secured physically and periodically counted and compared to recorded amounts.

Information and Communication are the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.

- Accounting system provides for separate identification of State and Federal and non-State and non-Federal transactions and allocation of transactions applicable to both.
- Adequate source documentation exists to support amounts and items reported.
- Recordkeeping system is established to ensure that accounting records and documentation retained for the time period required by applicable requirements; such as the Commonwealth Terms and Conditions for Human and Social Services and 808 CMR 1.04(1), and the provisions of laws, regulations, contracts or federal grant agreements applicable to the program.
- Reports provided timely to managers for review and appropriate action.
- Accurate information is accessible to those who need it.
- Reconciliations and reviews ensure accuracy of reports.
- Established internal and external communication channels:
  - Staff meetings.
  - Bulletin boards.
  - Memos, circulation files, e-mail.
  - Surveys, suggestion box.
- Employees' duties and control responsibilities effectively communicated.
- Channels of communication for people to report suspected improprieties established.
- Actions taken as a result of communications received.
- Established channels of communication between purchasing agencies and through subcontractors.

Monitoring is a process that assesses the quality of internal control performance over time.

- Ongoing monitoring built-in through independent reconciliations, staff meeting feed back, rotating staff, supervisory review, and management review of reports.
- Periodic site visits performed at decentralized locations (including subcontractors) and checks performed to determine whether procedures are being followed as intended.
- Follow up on irregularities and deficiencies to determine the cause.

- Internal quality control reviews performed.
- Management meets with program monitors, auditors, and reviewers to evaluate the condition of the program and controls.
- Internal audit and internal monitoring routinely tests for compliance with Commonwealth and federal requirements.

2. *Understanding the Entity's Internal Controls*

The objectives represent those goals and actions management wishes to achieve. while the components are the specific steps designed and prescribed by management to provide reasonable assurance that its objectives will be achieved. For example, to limit spending to the amounts negotiated with the Commonwealth in program budgets, contractor organizations have implemented detailed procedures for controlling expenditures. The objective is to limit spending to the amount negotiated, and the control procedures are those steps that must be performed before funds can be obligated and/or spent. These steps may include such actions as requiring certification by the accounting department that sufficient funds are available in the budget before obligating or expending funds.

The auditor can obtain information on the internal control components by reading contractor accounting and procedures manuals, reviewing past audit reports and evaluations, interviewing management and employees, and making observations.

Because of inherent limitations in the design and the operations of any internal control system, auditors should not expect internal controls to prevent or detect all instances of noncompliance or abuse. The most pervasive limitations are that the cost of internal controls should not exceed their benefits. In deciding how extensive the system of internal controls should be, management compares the costs of more controls with the benefits to be gained.

Other limitations include the possibility that management may override the internal control system; employees may secretly be working together (collusion) to avoid or circumvent the controls; and employees may not be correctly applying the control technique due to fatigue, boredom, inattention, lack of knowledge, or misunderstanding. As a result, auditors should always test actual transactions to have a reasonable basis for evaluating internal controls.

The auditors' understanding of the internal control system should be documented in the workpapers. This can be done through flowcharts; narratives; questionnaire responses, records of interviews, and copies of policies and procedures, documents, and records.

3. *Testing Controls*

For internal controls to be effective, they must be designed to achieve the intended objective(s) and must be correctly and consistently applied by the authorized employee(s). The best designed internal controls are of little value if the procedures are not correctly followed. For example, if the entity has a procedure requiring the manager's approval for all purchases over a specified dollar amount, but the manager does not review the purchase orders, this procedure will not be very effective in preventing or detecting unnecessary purchases.

Testing internal controls consists of the following steps:

- Defining what constitutes effective internal controls;
- Selecting a small sample of transactions, either randomly or non-randomly;
- Evaluating whether the sample transactions were executed in accordance with the laws and regulations and internal controls;
- Documenting the evaluation results; and
- Determining the probability that noncompliance will not be detected or prevented by the internal controls.

Auditors can use the results of the transaction tests to assess the probability that internal controls will not prevent or detect noncompliance.

4. ***Needed Corrective Actions***

If testing reveals material noncompliance or abuse, the auditor should determine what internal controls were intended to prevent, or detect the noncompliance or abuse and ascertain the reasons they did not. If internal controls are weak or nonexistent, many more transactions may be in noncompliance. Auditors should consider expanding tests to determine the impact of weaknesses on engagement objectives and of doing follow-on work.

* * * * *

Auditors should consult the fieldwork and reporting standards for internal controls in financial and performance audits as discussed in the GAO's "Yellow Book."

A sample Audit Risk Assessment Form has been provided as an attachment to this document. Government auditors often use a combination of tools, including forms for documenting and assisting in assessing risk components that estimate the possibility of error and irregularities in account balance, classes of transactions or procedures. The attached form has been designed to be used in conjunction with the guidance provided in pages 5 through 13 of this document for determining materiality and/or significance and audit risk, which govern the level of testing required or the inclusion of a potential finding in the report.

Reporting Requirements

GAO's government auditing standards require the following:

The auditors should prepare a written report on their tests of compliance with applicable laws and regulations. This report, which may be included in either the report on the financial audit or in a separate report, should contain a statement of positive assurance on those items which were tested for compliance and it should include all material instances of noncompliance and all instances or indications of likely irregularities or illegal acts which could have occurred.

If auditors find no instances or indications of material noncompliance, the compliance report must include:

- A statement of positive assurance that the test results indicate that with respect to the items tested, the entity complied in all material respects with the laws and regulations referred to in the scope.

If auditors find instances of material noncompliance, they should state that they considered these instances in forming their opinion on the financial statements and whether these instances affected their opinion and how. The statement on assurance should be similar to the following:

> **"Except as described above, the results of our tests of compliance with laws and regulations indicate that with respect to the items tested, the contractor complied in all material respects with the provisions referred to above and nothing came to our attention that caused us to believe that the contractor had not complied in all material respects with those provisions."**
>
> Instances of noncompliance with laws and regulations that are clearly inconsequential and nonmaterial from a quantitative and qualitative perspective must be reported to top management of the contractor via a management letter. If applicable, the compliance report should state that the auditors found instances of nonmaterial noncompliance with laws and regulations that are being separately reported to management. Instances of noncompliance with laws and regulations that occurred because of a weakness in the system of internal control must be reported in the report on internal control if such weakness is a reportable condition.

In all cases, instances of noncompliance with laws and regulations in the audit of a UFR should be reported by identifying:

- the condition of noncompliance;
- the effect of noncompliance in monetary and/or qualitative terms, if it can be determined;
- the criteria by which noncompliance was established;
- the cause of noncompliance, if it can be determined;
- recommendations for eliminating the noncompliance, if they can be developed.

Material findings of noncompliance should also be presented in their proper perspective:

- the size of the universe in number of items and dollars;
- the number and dollar amount of transactions tested by the auditors;
- the number of corresponding dollar amount of instances of noncompliance.

Further information on compliance reports can be found in chapters 5 and 7 of the 1994 "Yellow Book" and Statement on Auditing Standards 74, issued by the American Institute of Certified Public Accountants; Compliance Auditing Applicable to Government Entities and Other Recipients of Governmental Financial Assistance. In addition, contractor audit reports that are subject to the requirements of

OMB Circular A-133 must include a written report on compliance with laws and regulations that have a direct and material effect on each major federal program.

Audits of contractors for the purpose of Single Audit carry additional requirements that the auditor must be aware of to conduct the audit. These requirements are noted in the Executive Office of The President, Office of Management and Budget's publications, OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations and the Office of Management and Budget Compliance Supplement-Provisional 6/97.

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Auditors should consult the reporting standards for compliance in financial and performance audits as discussed in the GAO's "Yellow Book."

A sample Audit Risk Assessment Form has been provided as an attachment to this document. Government auditors often use a combination of tools, including forms for documenting and assisting in assessing risk components that estimate the possibility of error and irregularities in account balance, classes of transactions or procedures. The attached form has been designed to be used in conjunction with the guidance provided in this document for determining materiality and/or significance and audit risk, which govern the level of testing required or the inclusion of a potential finding in the report.

Suggested Areas of Compliance Testing

The majority of program services purchased by the Commonwealth are reimbursed through negotiated unit rate payments. Programs of social service purchased by the Commonwealth using negotiated unit rate payments deliver a program of discrete services which have performance and productivity requirements. These programs are disclosed in the Statement of Functional Expenses of the UFR and reported on in the Independent Auditor's Report on the Financial Statements. **Accordingly, independent auditors are expected to concentrate their testing and reporting efforts at the program and supporting service level as illustrated in the Statement of Functional Expenses of the UFR.**

Other unit rate payments are commonly and mistakenly identified as negotiated unit rate payments. These payments are usually for certain medical and social services priced using non-negotiated capitated and managed care rates, Medicaid eligible services, or for the delivery of goods and services such as pharmaceuticals, x-rays, accounting or temporary employment services rather than a program of social services. The organization, which is usually classified as a vendor, is being paid for the delivery of goods or units of service and is responsible for cost overruns.

The negotiated unit rate system of pricing and payment utilizes a rate calculation (unit rate/maximum obligation calculation page of contract Attachment B Program Budget) to establish a fixed price (maximum obligation) for a program of discrete services that is paid on a unit-of-service basis. Funding levels for these programs are established by considering the need for allowable program costs and performance and productivity levels. Programs that receive funding in this manner are often referred to as negotiated unit rate programs. The calculated rate reimburses the contractors for social services

outputs, outcomes and market based program costs previously identified in a negotiated program budget. Negotiated program budgets may be changed by amending the contract. Conditions for amendment of the contract include:

- Operating costs change because statutory and regulatory modifications cause funding decreases and increases;
- Type and quantity of services are modified because of change in statute or regulation;
- A change in the amount or availability of off-setting income from other sources of funding;
- Client's safety and well-being is gravely threatened because program costs increase beyond the control of the contractor;
- Reimbursable costs become greater or less than negotiated amount; and
- Changes in expected client utilization; and
- Program reconfiguration occurs during the life of the contract.

The negotiated unit rate system of pricing and payment utilizes the market prices for negotiation purposes which accomplishes the following:

- Eliminates program costs that are not needed or should not be reimbursed with public funds;
- Accommodates program reconfiguration or other changes through contract amendment;
- Provides for adequate cash flow by permitting the retention of five percent of excess program revenues generated by good management practices and;
- Removes contractor responsibility for cost overruns.

The contractor's contract with the Commonwealth for the delivery of a program of social services has minimum and mandatory program requirements. The contract also includes specific and measurable criteria and standards for evaluating the contractor's productivity and performance in relation to desired individual client outcomes or overall program objectives. The contract mandates that the organization reports and meets these performance and productivity requirements and complies with applicable laws, non-reimbursable cost requirements and other regulatory requirements. Productivity and performance output and outcome measurements are the primary standards used in negotiated unit rate programs to determine if the contractor has fulfilled its contractual obligations.

The terms of the contractor's contract with the Commonwealth require the contractor and its subcontractors to maintain records of all types of expenses and income or other funds pertaining to the program paid to the contractor by every source, including each client. The contract specifies that the contractor and subcontractor(s) shall keep all data as necessary to satisfy applicable reporting requirements of DPS, the Division of Health Care Finance and Policy and purchasing departments. Contractors are also required to maintain financial books, supporting documents, statistical records, and all other records that reflect revenues associated with and costs incurred in or allocated to any program of services rendered under the Service Contract. In addition, the contract requires the

contractor and subcontractor(s) to maintain adequate internal controls and books and records in accordance with generally accepted accounting principles. Accordingly, the independent auditor must observe the GAGAS auditing standards for financial statement audits and performance audits concerning internal controls in paragraphs 4, 5, 6 and 7 of the 1994 revision of the Yellow Book when conducting field work and reporting on an audit of the UFR. The audit of the UFR requires the independent auditor to pay particular attention to internal controls over compliance with laws and regulation and management controls that are discussed in paragraphs 4.30 and 6.39 through 6.45 of the 1994 revision of the Yellow Book.

The cost reimbursement method of pricing and payment is also utilized for the purchase of social services by the Commonwealth. The cost reimbursement pricing structure reflects a purchase arrangement in which the purchasing agency pays the contractor for budgeted costs that are actually incurred in delivering the services specified in the contract, up to a stated maximum obligation. In cost reimbursement situations, any budgeted cost that is not actually incurred, including the allocation of administration, can neither be billed by the contractor nor reimbursed by the purchasing agency. **All excess revenues that are generated as a result of budgeted costs not being incurred by the contractor but reimbursed by the purchasing agency in cost reimbursement contracts must be passed on to the Commonwealth. Any overbilling in a cost reimbursement contract requires the independent auditor to write a finding of overbilling in the compliance report.** The contractor should initiate a corrective action plan in response to the auditor's finding. The final signed corrective action plan should indicate that the contractor disclosed a liability to the Commonwealth in its financial statements and agreed to a schedule of repayment(s), that has been identified in the corrective action plan, with the Commonwealth purchasing agency(s) that is a party to the written corrective action plan.

Regulations and contract terms and conditions that govern the establishment and administration of rates of payment and contracts are attached to this document.

For negotiated unit rate and cost reimbursement programs, the auditor's examination should be directed to areas that could, by virtue of noncompliance with laws and regulations and disallowance, have a direct and material effect on the financial statement amounts. Given that the Independent Auditor is opining on the amounts disclosed in the Statement of Functional Expenses the auditor's examination should be directed to the program services and supporting services disclosed in the Statement of Functional Expenses and Schedules B, B-1, C, and D of the UFR. The auditor should obtain an understanding of management's responsibilities concerning the contractual requirements established in the general conditions of its Master Agreement with the Commonwealth (including the internal control requirements noted above) and the non-reimbursable cost provisions of 808 CMR 1.15 (Effective 2/1/97 808 CMR 1.05). The Division of Purchased Services will determine the annual excess revenues generated through negotiated unit rate programs pursuant to the provisions of 808 CMR 1.19 (3) Not-for-Profit Provider Surplus Revenue Retention (Effective 2\1\97 808 CMR 1.03 (7)). Given this fact, the auditor's examination should not be directed to this area for compliance with the revenue retention provisions of 808 CMR 1.19 (3) other than to ensure that appropriate disclosure occurs.

Each compliance requirement below is generally considered to be inherently risky and highly susceptible to noncompliance. Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements are also included. The auditor should consider these areas when performing the vulnerability assessment for determining the extent of compliance testing needed in each program of service and supporting service. The need or extent of compliance testing in these areas has not been mandated but instead is directly related to the contractor's degree of vulnerability.

The **suggested** audit procedures associated with the compliance requirements below are intended to be illustrative, **not** comprehensive or mandatory. The design of appropriate audit tests should be based upon the auditor's professional judgment.

Allocation of Costs

***Compliance Requirement*:** Contractor organizations must maintain financial books and records which distinguish the direct expenses of each program receiving Commonwealth funds and which make a reasonable allocation of the organization's indirect expenses (costs which pertain to various functions) to such programs. Indirect expenses that are not related to direct services such as management and general/administration and certain administrative expenses should normally not be allocated to various functions on the basic financial statements.

Source: 808 CMR 1.04 (1) Recordkeeping.

- Review the chart of accounts and books of original entry to determine if they distinguish and segregate the income and direct expenses associated with programs funded by the Commonwealth.
- Determine whether the contractor has written cost allocation policies and plans.
- Review indirect cost allocation policies, plans, worksheets, etc., to determine if allocations are reasonable and in accordance with recommendations of the AICPA "Industry Audit Guide for Audits of Voluntary Health and Welfare Organizations" for "Allocation of Costs Which Pertain to Various Functions" and SOP 78-10 par. 100.

***Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements*:**

Incorrect interpretation of the AICPA recommendations for allocation of costs which pertain to various functions or recording and reporting through error; or

Committing irregularities, such as the intentional allocation of administrative costs for the overall direction of the organization to program or fund-raising functions, in an effort to portray the contractor (for the benefit of contributors, financial lending institutions and governmental jurisdictions) as having minimal administrative expenditures; or

Allocation of administrative costs to programs receiving funding from the Commonwealth in a fraudulent or illegal manner for the purposes of increasing reported reimbursable program costs used to support billings and formulas for reimbursement which could result in a disallowance.

Debarment and legal action. These actions would result in a direct and material effect on the financial statement amounts, including a misstatement of administrative, program and fund-raising functions on the Statement of Functional Expenses and a liability to the Commonwealth on the Balance Sheet.

The AICPA recommendations prohibit allocation of administrative (management and general) costs for the overall direction of the organization to program and fund-raising functions. The portion of time spent directly supervising program, fund-raising or service activities, such as salaries and expenses, should be prorated among those functions. Administrative costs for the overall direction of the organization, including general record maintenance, general board activities, and salaries and expenses of the chief officer of the organization and/or his staff, could be incorrectly allocated to program and fund-raising functions, as noted above.

Allowable Services

Compliance Requirement: The contractor organization must ensure that the amounts reported as program expenditures for programs funded by the Commonwealth were for allowable services as defined in the contractor's standard service contract or agreement with the Commonwealth.

Source: Commonwealth of Massachusetts Standard Contract Form Attachment 1.

Suggested Audit Procedures:

- Review contractor program descriptions and interview staff to determine if the services delivered are consistent with the allowable services defined in the standard service contract.
- If the use of fixed assets are an integral part of the program, determine by observation that the resources are available and being utilized.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of allowable service criteria or recording and reporting through error; or

Committing irregularities, such as intentionally reporting or billing for services that are not allowed, in an effort to provide services other than those covered in the contract and/or portraying the contractor as having fulfilled all of its contract service delivery obligations; or

Fraudulent or illegal reporting and billing for services that have not been provided in accordance with the terms and conditions of the contract with the Commonwealth could result in disallowance, debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a misstatement of program functions on the Statement of Functional Expenses and a liability to the Commonwealth on the Balance Sheet.

Eligible Clients

Compliance Requirement: The contractor organization must ensure that the amounts reported as program expenditures for programs funded by the Commonwealth were for eligible clients as defined in the contractor's standard service contract or agreement with the Commonwealth.

Source: Commonwealth of Massachusetts Standard Contract Form Attachment 1.

Suggested Audit Procedures:

- Review contractor admission and client eligibility determination procedures and determine if program services are being delivered to eligible clients in accordance with the client profile, admission and financial eligibility criteria of the standard service contract or agreement.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of client eligibility criteria or recording and reporting through error; or

Committing irregularities such as intentionally reporting or billing for ineligible clients in an effort to provide services to individuals not meeting contract eligibility criteria and/or portraying the contractor as having fulfilled its service delivery obligations to eligible clients of the contract; or

Fraudulent or illegal reporting and billing for services provided to clients who do not meet client contract eligibility criteria could result in a disallowance, debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a liability to the Commonwealth on the Balance Sheet.

Performance and Service Documentation

Compliance Requirement: The contractor organization must ensure that performance information and amounts reported as program income and expenditures for programs funded by the Commonwealth in the UFR were supported by a system that measures performance and establishes targets to be achieved in the form of outputs and outcomes. Contractor organizations must maintain a system of documenting and reporting client attendance, client encounters or services delivered which:

- identifies individual consumers/clients with the services and attained output measures each has received;
- identifies, by program, all attained output measures and service units actually rendered or delivered;
- identifies whether and to whom services were billed; and
- identifies and relates attained output measures to service units and desired outcomes.

Source: Commonwealth of Massachusetts Standard Contract Form Attachment 1 and 2.

Suggested Audit Procedures:

- Review contractor performance monitoring and evaluation system to determine if management is furnished with attained performance information derived from an internal performance reporting system. Determine if monitoring and evaluation system evaluates attained output measures and units of service rendered in relation to targets to be achieved and the desired outcomes in accordance with program performance and utilization criteria of the standard service contract or agreement.
- Ascertain whether the contractor maintains a system which documents and records, as appropriate, client attendance, client encounters, attained output measures and units of service delivered.
- Review the system and records to determine if they satisfy the above criteria.
- Selectively sample and trace invoices to the Commonwealth for services rendered to supporting documentation (service delivery records).
- Selectively sample internal and UFR performance reports to output measurement supporting documentation.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of performance and service documentation requirements or recording and reporting through error; or

Committing irregularities, such as intentionally reporting or billing for services not supported by accurate performance and service delivery documentation for measuring outputs and units of service delivered, in an effort to provide services to ineligible individuals and/or to embellish service delivery attained outputs and client utilization or to portray the contractor as having fulfilled these requirements; or

Fraudulent or illegal reporting or billing for services in accordance with performance and service delivery requirements of the contract or for services that have not been provided could result in disallowance, debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a liability to the Commonwealth on the Balance Sheet.

Contractor organizations that are reimbursed for a program of social services through the negotiated unit rate system of pricing and payment, which utilizes a formula to establish a fixed price (maximum obligation), are paid on a unit of service basis. The contracts for these programs have minimum or mandatory program requirements and specific and measurable criteria and standards for evaluating the contractor's productivity and performance. Productivity and performance measurements are the primary standards used in negotiated unit rate programs to determine if the contractor has fulfilled its contractual obligations.

Program FTE Documentation

Compliance Requirement: Contractor organizations must maintain a system of documenting each full- and part-time employee's attendance, hours worked, program assignments and payroll expenses to enable the organization to prepare an accurate

schedule of full-time equivalent employees and associated payroll expenses by job category and program.

Source: 808 CMR 1.04 (1) Recordkeeping and Commonwealth Terms and Conditions for Human and Social Services, Recordkeeping and Retention, Inspection of Records

Suggested Audit Procedures:

- Ascertain whether the contractor maintains a system of documenting employees' time and attendance, payroll expenses and program assignments.
- Review the system's records to determine whether they identify:
  - individual employee's total time and attendance;
  - individual employee's job category;
  - individual employee's program assignments or, in the case of employees assigned to work in more than one program, the proportion of time devoted to each; and
  - individual employee's payroll expenses.
- Selectively test and trace "Employee Compensation" reported on the Statement of Functional Expenses to supporting documentation (time sheets, attendance records, etc.).

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Absence of a system for documenting employee's time and attendance, payroll expense and program assignments or the incorrect interpretation of its maintenance requirements could increase the risk of recording and reporting through error; or

Committing irregularities, such as intentionally reporting or billing for services not supported by accurate documentation for supporting employee's time and attendance, payroll expense and program assignments, in an effort to provide services with less or different employee staffing than what is required in the contract or to embellishing staffing assignments and employee-related expenses or portraying the contractor as having fulfilled licensing requirements; or

Fraudulent or illegal reporting or billing for services not in accordance with staffing, related employee expenses and licensing requirements of the contract could result in disallowance, debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a liability to the Commonwealth on the Balance Sheet.

Client Custodian Funds

Compliance Requirement: A contractor organization which serves as a client's representative payee for SSI purposes, which, as a fiduciary, holds and manages the personal funds of clients specifically identified, referred or deemed eligible for the program by the Commonwealth under a contract or agreement, must do so in accordance with the guidelines of applicable Commonwealth of Massachusetts purchasing agencies.

Source: Commonwealth Purchasing Agency Regulations and Policies and Commonwealth Terms and Conditions for Human and Social Services, Human and Social Services Contracting Provisions b. Client Care and Use of Funds

Suggested Audit Procedure:

- Determine (client representation) whether the contractor acts as a representative payee or otherwise acts as a fiduciary with respect to client personal funds.
- Determine whether the appropriate Commonwealth of Massachusetts agency has promulgated rules, regulations or policies governing the contractor's fiduciary duties with respect to client funds by inquiry to the contractor's contact officer for that agency.
- Obtain an understanding of the requirements of said rules, regulations, etc.
- Selectively sample and test transactions to determine whether the material provisions of said rules, regulations, etc., have been followed.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of client custodian fund record maintenance requirements or recording and reporting through error; or

Committing irregularities, such as intentionally recording or reporting client custodian funds in a manner not in accordance with established accounting principles, purchasing agency policies, regulations or legal requirements, in an effort to use these funds for unauthorized purposes or to portray the contractor as having fulfilled custodial responsibilities; or

Fraudulent or illegal reporting and use, including defalcation of client custodial funds, could result in debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a misstatement of custodian funds or a liability to clients on the Balance Sheet.

Contractor Reimbursements/Stipends

Compliance Requirement: Contractor organizations which operate family day-care or foster-care programs funded by a Commonwealth contract or agreement must pay third-party, family day-care or foster-care contractors at the rate established by the Commonwealth. The third-party payments must be the same as the contractor's reimbursement/stipend expenses.

Source: Commonwealth Purchasing Agency Policies

Suggested Audit Procedure:

- Determine whether the contractor organization operates family day-care, foster-care, or other programs in which third-party contractors are required to be reimbursed at rates established by the Commonwealth.
- Reconcile total contractor reimbursement/stipend expenses and report any differences.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of contractor reimbursements and stipend payment (pass through) and record maintenance requirements or recording and reporting through error; or

Committing irregularities, such as intentionally recording or reporting payments to third-party contractors not in accordance with established purchasing agency policies, in a effort to use these funds for unauthorized purposes or to portray the contractor as having fulfilled financial management responsibilities; or

Fraudulent or illegal reporting and use, including defalcation of third-party reimbursements or stipends, could result in disallowance, debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a misstatement of custodian funds or a liability to the third party and the Commonwealth on the Balance Sheet.

Assets Held in Trust for the Commonwealth

Compliance Requirement: Title to all furnishings, equipment and other assets furnished to the contractor organization by the Commonwealth or wholly purchased with funds received from the Commonwealth pursuant to a contract or agreement vests in the Commonwealth. The contractor organization must maintain a written inventory of all such property, including a description and location of each item.

Source: Commonwealth of Massachusetts Standard Contract Form Attachment 6 Capital Budget and 808 CMR 1.04(5)

Suggested Audit Procedure:

- Determine (client representation with respect to assets acquired in prior years and review of current year contracts and agreements) whether the contractor has possession of any assets furnished by the Commonwealth or wholly purchased with funds received pursuant to a contract or agreement.
- Determine whether the contractor maintains asset records which identify and account for such furnishings and equipment.
- Selectively sample and test the records maintained and inventories performed for the following requirements:
  - Written Inventory of all such property;
  - Description of each item; and
  - Location of each item.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of free use of facilities and other asset record maintenance requirements or recording and reporting through error; or

Committing irregularities, such as intentionally recording or reporting free use of assets not in accordance with established accounting principles, purchasing agency policies, regulations or legal requirements, in an effort to portray the contractor as having the use or ownership of more or less assets than it actually has or to represent that all custodial responsibilities have been fulfilled; or

Fraudulent or illegal reporting and use, including defalcation of commonwealth assets, could result in debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a misstatement or a liability to the Commonwealth on the Balance Sheet.

Disclosure of Non-Reimbursable Costs

Compliance Requirement: Contractor organizations are required to disclose the existence and value of all anticipated non-reimbursable costs, as identified in 808 CMR 1.15 (1) - (27), and identify the offsetting revenue used to defray the non-reimbursable costs in program budgets of contracts with purchasing agencies of the Commonwealth. All incurred non-reimbursable costs and their value must be reported in Supplemental Schedule B Expenses of the Uniform Financial Statements and Independent Auditors Report (UFR) as either a state or federal non-reimbursable cost.

Source: Regulation 808 CMR 1.05 Non-Reimbursable Costs and Contract Instructions and Forms issued by the Division of Purchased Services.

Suggested Audit Procedure:

- Review and become familiar with the twenty seven (27) non-reimbursable cost provisions of 808 CMR 1.15. These provisions also include by reference the federal cost principles of OMB Circular A-122 and A-21 as appropriate when the contractor directly or indirectly receives federal assistance.
- Determine (contractor representation with respect to non-reimbursable costs in prior years and review of current year contract program budgets) whether the contractor has anticipated the existence of any non-reimbursable costs.
- Determine whether the contractor maintains records as part of its internal control structure which identifies and accounts for non-reimbursable costs.
- Review the records maintained for the following requirements:
  - Written definition of non-reimbursable costs;
  - Description of each anticipated and incurred non-reimbursable cost; and Identification of fund, program and dollar value related to each non-reimbursable cost.
- Selectively sample and test the expense records to determine that non-reimbursable costs were properly classified, valued and posted in the accounting records and disclosed in the contractor's current year contract program budgets and UFR.
- Determine that unrestricted revenues and revenues restricted by donors for use in defraying non-reimbursable costs were available and accurately reported in the UFR as being used to offset (defray) all non-reimbursable costs in programs that the Commonwealth purchases services.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of the definition and disclosure requirements of non-reimbursable costs and other requirements or recording and reporting through error; or

Committing irregularities, such as intentionally recording or reporting non-reimbursable costs not in accordance with established accounting principles, purchasing agency policies, regulations or legal requirements, in an effort to portray the contractor as having less non-reimbursable costs than it actually has or to represent that all disclosure responsibilities have been fulfilled; or

Fraudulent or illegal reporting and use, including defalcation of commonwealth funds, could result in debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a misstatement or a liability to the Commonwealth on the Balance Sheet.

Related Party Disclosure

Compliance Requirement: Contractor organizations are required to disclose the existence and non-reimbursable value of all anticipated related party transactions (related party is defined in accordance with SFAC No. 57 pursuant to 808 CMR 1.02 in program budgets of contracts with purchasing agencies of the Commonwealth. The non-reimbursable value of all incurred related party transactions must be disclosed in Supplemental Schedule B Expenses of the UFR. In addition, all related party relationships must be disclosed in the Notes to the Financial Statements of the UFR. The following DPS related party materiality and disclosure guidance should be considered in determining if disclosure is required in the GAGAS audited financial statements of the UFR.

- Contractors that receive funding from the Commonwealth for the operation of social service programs:

  Generally, DPS recommends that all related party relationships and transactions, as defined by 808 CMR 1.02, associated with contractors receiving funding for the operation of social service programs from the Commonwealth (state agencies and local education authorities) be considered material related party transactions in accordance with GAGAS. These material related party transactions should be disclosed in the notes to the financial statements of the UFR. Two exceptions to this consideration may, to the extent allowed by the **qualitative materiality factors** of GAGAS, as noted below, include the following:

  * Individual or aggregated monetary related party transactions where the total value of transactions with the related party was less than one hundred dollars ($100) within the year.

  * Gifts furnished to the contractor by an official, administrator or manager of the contractor.

This greater degree of GAGAS materiality is predicated upon the sensitive nature of contractors operating Commonwealth-purchased programs and the penalties and sanctions associated with failure to provide disclosure of related party transactions and relationships in the UFR. Failure to disclose material related party transactions in accordance with GAGAS could result in penalties or a disallowance of related party costs which could materially affect the financial statement amounts. These possible actions dictate that most contractor related party relationships and transactions should be considered material in accordance with GAGAS. In addition, the GAGAS materiality level for disclosure of related party transactions is further magnified by the prior disclosure requirements for related party transactions and relationships established pursuant to Chapter 495, Section 99 of the Acts of 1993 and 808 CMR 1.04 (5) and (7). Audit risk associated with disclosure of related party transactions in the contractor's financial statements and/or the auditor's report on compliance would be substantially increased if the contractor did not comply with these prior disclosure of related party transaction requirements. Noncompliance with the prior disclosure requirements could include the following penalties that may materially affect the financial statement amounts: Failure to furnish prior disclosure of **all contractor related party transactions in excess of $100** (Except for gifts furnished to the contractor by an official, administrator or manager of the contractor) pursuant to 808 CMR 1.04 (5) and (7) could result in DPS ordering that the service contract or service contracts directly affected by the violation of related party prior disclosure requirements be terminated or the assessment of a civil penalty of no more than $2,000 or 10% of the contractor's annual maximum obligation under such contract or contracts, **whichever is greater** and the debarment of the contractor for a period not to exceed five years in the event of repeated willful violations of 808 CMR 1.04 (5).

Source: Regulation 808 CMR 1.04 Filing and Reporting Requirements, regulatory standards and instructions of the UFR and Contract Instructions and Forms issued by the Division of Purchased Services.

Suggested Audit Procedure:

- Review and become familiar with the definition of a related party as defined in 808 CMR 1.02 and Financial Accounting Standards No. 57 (SFAS No. 57), incorporated by reference, and disclosure requirements. The auditor should also become fully acquainted with the requirements and recommendations as codified in the AICPA Professional Standards, Statement on Auditing Standards No.45 (SAS No. 45) and Auditing Interpretations of Section Au 334 (Au Section 9334) and the Generally Accepted Government Auditing Standards (GAGAS) definition of material.
- Determine (contractor representation with respect to related party relationships and transactions in prior years and review of current year contract program budgets) whether the contractor has anticipated the existence of any related party relationships.
- The auditor should consider and obtain representations from the contractor's senior management and its board of directors as to whether they or any other related parties engaged in any transactions with the contractor during the period, as recommended in Au Section 9334.

- Determine the existence of related party relationships and transactions by utilizing and applying the accounting considerations audit procedures prescribed by SAS 45 and Au Section 9334 to the contractor's activities.
- Determine that the contractor has disclosed all material related party relationships and transactions as the following requires:

  In government audits and in the Purchase of Service System, the materiality level and threshold for related party disclosure is lower than in similar-type audits in the private sector because of public accountability of the entity, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions. All related party relationships or transactions, as defined by 808 CMR 1.02 and SFAS No. 57, that are associated with programs that are purchased by the Commonwealth are considered material and must be disclosed in current year program budgets and the UFR.

  All related party transactions in programs that are not purchased by the Commonwealth that could affect the contractors financial statements and all instances of common ownership or management control relationships for which 808 CMR 1.02 and SFAS No. 57 requires disclosure even though there are no transactions should be considered material in accordance with the criteria established by GAGAS and must be disclosed in the UFR.

- Determine that the contractor has disclosed the following information for all material (GAGAS definition of material) related party relationships and transactions:

  a. Nature of related party relationship;
  b. The receivables or payables associated with related party transactions for each period the balance sheet or program budget is presented, and, if not clearly determinable, the conditions and methods of settlement;
  c. For each period that an income statement or program budget is presented, the following is required:
     (1) A description of transactions and other necessary information needed for an understanding of the impact of the transactions; and
     (2) Dollar amounts assigned to transactions, and the impact of determining the terms of the transactions, if different from prior periods;

  d. If two or more companies are under common control via ownership or management, the disclosure in a. above is required, even though no transactions occurred, if the existence of that control could result in operating results or financial position significantly different from that which would have been obtained if the enterprises were autonomous.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of the definition and disclosure requirements of related party relationships and transactions, and other requirements or inaccurate recording and reporting through error; or

Committing irregularities, such as intentionally recording or reporting the nature and value not in accordance with established accounting principles, purchasing agency policies, regulations or legal requirements, in an effort to portray the contractor as having no related party relationships or a lesser value of related party transactions than it actually has, or to represent that all disclosure responsibilities have been fulfilled; or

Fraudulent or illegal reporting and use, including defalcation of commonwealth funds, could result in debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a misstatement or a liability to the Commonwealth on the Balance Sheet.

Record Keeping

Compliance Requirement: Contractor organizations are contractually required to maintain their financial books and record keeping systems in accordance with generally accepted accounting principles (GAAP) as set forth in the American Institute for Certified Public Accountants AICPA industry audit guide, Audits of Voluntary Health and Welfare Organizations, as specified in 808 CMR 1.04. The record keeping system of contractor organizations must keep on file data as are necessary to satisfy applicable reporting requirements of the Division of Purchased Services (DPS). Contractor financial statements prepared in accordance with generally accepted accounting principles as set forth in the AICPA Audit and Accounting Guide for Not-For-Profit Organizations and audited in accordance with generally accepted government auditing standards (GAGAS) are contractually required to be filed with DPS. Financial books and records of contractors must reflect revenues from every source, including each client, associated with and costs incurred in or allocated to any program of services rendered.

Source: 808 CMR 1.04 (1) Recordkeeping

Suggested Audit Procedure:

- Ascertain whether the contractor maintains a system of recording and documenting all revenues and expenses related to every source by fund and program on a functional and natural basis.
- Determine whether the contractor has written cost allocation policies and plans that have been established in accordance with the recommendations of the AICPA Audit and Accounting Guide for Not-For-Profit Organizations and the DPS UFR Instructions for "Allocation of Costs Which Pertain to Various Functions."
- Ascertain whether the contractor maintains records and procedures in accordance with the following provisions of GAAP which are contractually required:
  - Preparation and maintenance of up-to-date statement of job description and responsibilities.
  - Preparation and maintenance of a statement of job qualifications.
  - Maintenance of resumes and job applications of employees, including name, address, social security number, education and/or experience, and copies of all licenses and certifications required to perform the job.

- Payroll and time and attendance records documenting program assignment and hours and days worked as prescribed by Federal Fair Labor Standards Act of 1938, as amended part 516 and MGL c. 151 the minimum Fair Wage Law.

- Ascertain whether the contractor maintains other records and procedures in accordance with GAAP that provide internal control over the classification of expenditures as follows:
  - Preparation of a detailed budget which incorporates Commonwealth purchased program services that is reviewed periodically by a committee of directors or trustees.
  - Preparation of studies of the services performed by employees who serve more than one function, to determine the bases for allocating their salaries and expenses.
  - Use of written instructions to employees on the preparation of time and expense reports covering the method to be followed in determining and indicating services being performed.
  - Preparation and maintenance of up-to-date organization charts.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of the record keeping requirements of the contract could result in an inability to meet reporting requirements or inaccurate recording and reporting through error; or

committing irregularities, such as intentionally recording or reporting the nature and value not in accordance with GAAP, purchasing agency policies, regulations or legal requirements, in an effort to portray the contractor as having financial program activities other than it actually had or to represent that all contractual and legal responsibilities have been fulfilled; or

fraudulent or illegal reporting and use, including defalcation of Commonwealth funds, could result in debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a misstatement or a liability to the Commonwealth on the Balance Sheet.

Offsetting Income

Compliance Requirement. Client resources and/or third-party payments made on behalf of a client as well as other off-setting revenue in a Commonwealth-funded social service program must first be used by the contractor to reduce the amount of the appropriate purchasing agency's obligation for the service rendered to the client (note the maximum financial obligation of the purchasing agency does not include non-reimbursable costs pursuant to 808 CMR 1.15). Further, even if client resources or third-party payments made on behalf of a client is not anticipated in the program budget or otherwise in the computation of the price, the amount of the resources or third-party payments actually received must be used to reduce allowable costs related to the purchasing agency's obligation for client services. The contractor's social service program budget may also anticipate voluntarily designated unrestricted revenues and support or donor restricted

revenues and support to be used as offsetting income for reducing allowable costs related to the purchasing agency's obligation for client services. In addition, social service programs that receive federal financial assistance are subject to similar provision promulgated by the Presidents Office of Management and Budget (OMB) (see *administrative compliance requirements* for *program income* in OMB Circular A-133 Compliance Supplement).

Source: The provisions of 808 CMR 1.02 Offsetting Revenue and 808 CMR 1.03(5), applicable to all contractors

Suggested Audit Procedure:

- Ascertain whether the Attachment B Program Budget of the contract includes offsets and the source and amount of the offsets used to reduce the Commonwealth's maximum obligation by reviewing cost reimbursement offsets and unit rate offsets (unit rate calculation page).
- Determine whether the contractor received client resource, third-party revenues, voluntarily designated unrestricted revenues and support and/or donor restricted revenues and support during the contract period and if these revenues were used in the Attachment B Program Budget to reduce the Commonwealth's maximum obligation.
- Determine whether the contractor's contract was amended or if invoices submitted to the Commonwealth during the year were reduced to further offset the Commonwealth's maximum obligation for any additional unanticipated client resource and/or third-party revenues received during the year.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of the offsetting income requirements of the contract (includes federal program income provisions if federal assistance is furnished by the Commonwealth) could result in an inability to meet budgeting requirements or inaccurate recording and reporting through error; or

committing irregularities, such as intentionally recording or reporting the nature and value not in accordance with, Division of Purchases Services and purchasing agency policies, regulations or legal requirements, in an effort to portray the contractor as not having offsetting income that it actually had or to represent that all contractual and legal responsibilities have been fulfilled; or

fraudulent or illegal reporting and use, including defalcation of Commonwealth funds, could result in debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a misstatement or a liability to the Commonwealth on the Balance Sheet.

Fiscal Year 1998 Direct Care Salary Reserve Increase Agreement

Compliance Requirement. In fiscal year 1998 certain contractors entered into a contractual agreement with Commonwealth purchasing departments specified as in each agreement pursuant to the terms of Chapter 43 of the Acts of 1997, item 1599-6896 and the Division of Purchased Services (DPS) Salary reserve Implementation Plan. The agreement was executed for the purpose of funding a salary increase for the period of

July 1, 1997 to June 30, 1998, of up to 15% of its allocation for eligible direct care workers earning less than $30,000 in annual compensation who work in programs under Commonwealth department contracts with the contractor as specified in the agreement. The agreement also specifies a net Fiscal Year 1998 maximum obligation for accomplishing the salary increase for the Fiscal Year 1998 period (copy of blank agreement is attached) and that the Contractor's (Provider's) independent auditor shall test for compliance with the terms of the agreement as part of the Contractor's (Provider's) Fiscal Year 1998 audit.

Source: Chapter 43 of the Acts of 1997, item 1599-6896 and the Division of Purchased Services (DPS) Salary reserve Implementation Plan.

Suggested Audit Procedure:

- Ascertain whether the contractor has executed a FY '98 Direct Care Salary Reserve Increase Agreement with Commonwealth purchasing departments.
- Determine whether the contractor has submitted valid, accurate salary survey data pursuant to the terms of the agreement with the Commonwealth purchasing departments.
- Determine that all funds received through the agreement were used for salary increases and the employer portion of payroll taxes (FICA, unemployment insurance, workers' compensation insurance and FUTA not to exceed 15% of the allocation) and directly associated with the salary increases, for eligible direct care workers earning less than $30,000 in programs specified as being funded in the agreement.
- Determine that the salary increases were provided on a retroactive basis to July 1, 1997 to eligible workers beginning no later than October 1, 1997 or within 10 days of the receipt of the funds by the contractor, whichever is later.
- Determine that contractors awarded salary increases to eligible workers based on performance and that salary increases were not given to employees whose performance was rated unsatisfactory on their most recent performance appraisal or who are currently subject to disciplinary action.
- Determine that the contractor maintained until June 30, 2005, detailed data to support the salary survey and submission and documentation describing how the funds were actually distributed for all agreements.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of the terms and requirements of the salary reserve increase agreement could result in inaccurate recording, disclosure and reporting through error; or

committing irregularities, such as intentionally recording or reporting the nature and value not in accordance with GAAP, or the specifications of the direct care salary reserve increase agreement, in an effort to portray the contractor as having financial program activities other than it actually had or to represent that all contractual and legal responsibilities have been fulfilled; or fraudulent or illegal reporting and use, including defalcation of Commonwealth funds, could result in debarment and legal action. The agreement specifies that failure by the contractor to comply with any of

the terms of the FY '98 Direct Care Salary Reserve Agreement would cause the funds to be subject to immediate recoupment, or such other actions as may be necessary to recover such funds, costs or damages for breach of the agreement. These actions would have a direct and material effect on the financial statement amounts, including a misstatement or a liability to the Commonwealth on the Balance Sheet.

Cost Reimbursement Contract Overbilling

Compliance Requirement. The cost reimbursement pricing structure reflects a purchase arrangement in which the purchasing agency pays the contractor for budgeted costs that are actually incurred in delivering the services specified in the contract, up to a stated maximum obligation. In cost reimbursement situations, any budgeted cost that is not actually incurred, including the allocation of administration, can neither be billed by the contractor nor reimbursed by the purchasing agency. **All excess revenues that are generated as a result of budgeted costs not being incurred by the contractor but reimbursed by the purchasing agency in cost reimbursement contracts must be passed on to the Commonwealth. Any overbilling in a cost reimbursement contract requires the independent auditor to write a finding of overbilling in the compliance report.** The contractor should initiate a corrective action plan in response to the auditor's finding. The final signed corrective action plan should indicate that the contractor disclosed a liability to the Commonwealth in its financial statements and agreed to a schedule of repayment(s), that has been identified in the corrective action plan, with the Commonwealth purchasing agency(s) that is a party to the written corrective action plan.

Source: State Finance Law; Policies and Procedures Handbook for Human and Social Services, Principles of Program Pricing.

Suggested Audit Procedure:

- Determine whether the contractor was reimbursed for any budgeted costs billed to the Commonwealth that were actually not incurred.
- Determine that all costs reimbursed by the Commonwealth were included in the cost reimbursement contract program budget.
- Determine whether the contractor was reimbursed for any costs exceeding any one of the four program component cost categories maximum obligations of the program budget.
- Determine if total reimbursements form the Commonwealth exceeded actual allowable and reimbursable costs incurred by the contractor.
- Determine if the contractor maintains adequate internal controls to avoid overbilling the Commonwealth for costs not actually incurred, costs not previously approved in the program budget and total costs exceeding all component costs categories maximum budget obligations.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Incorrect interpretation of the requirements for cost reimbursement contracting or recording and reporting through error; or

Committing irregularities, such as intentionally recording or reporting and billing for costs not in accordance with established, purchasing policies, regulations or legal requirements, in an effort to portray the contractor as having more reimbursable costs than it actually has or to represent that all disclosure responsibilities have been fulfilled; or

Fraudulent or illegal reporting and use, including defalcation of commonwealth funds, could result in debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a misstatement or a liability to the Commonwealth on the Balance Sheet.

Internal Controls

Compliance Requirement. The Commonwealth Terms and Conditions for Human and Social Services requires the contractor to maintain records, books, files and other data as required by 808 CMR 1.04(1) and the instructions of the UFR is such detail as shall properly substantiate claims for payment. The contractor is also required to maintain adequate written policies and procedures for accounting management and personnel activities in accordance with GAAP, including but not limited to conflict of interest and nepotism policies. If a non-profit organization, the contractor shall comply with the principles in the Massachusetts Attorney General's "Guide for Board Members of Charitable Organizations" and with the standards for boards contained in the AICPA's statements on auditing standards, as may be amended from time to time. Organizations receiving federal financial assistance must adhere to the internal control requirements contained in OMB Circular A-110. Auditors should consult the provisional compliance supplement for OMB circular A-133 for more information concerning specific internal control requirements.

Source: Commonwealth Terms and Conditions for Human and Social Services.

Suggested Audit Procedure:

- Assess the adequacy of the Contractor's internal controls in accordance with statement on auditing standards (SAS) number 78 and OMB Circular A-110 if applicable. The provisional compliance supplement for OMB Circular A-133 and this publication provides information that can be used for assessing the adequacy of the Contractor's internal controls by providing sample characteristics relating to each of the five components of internal control.
- Assess the adequacy of the Contractor's internal controls pertaining to compliance requirements for Commonwealth funded organizations, activities and programs.

Examples that increase the risk of noncompliance and could have a direct and material effect on the financial statements:

Inadequate internal controls could result in the preparation of unreliable financial statements, reduced accountability over assets and noncompliance with laws, regulations and other compliance requirements. Inadequate internal controls permits recording and reporting through error; or

Committing irregularities, such as intentionally recording or reporting and billing for costs not in accordance with established, purchasing policies, regulations or legal requirements, in an effort to portray the contractor as having more reimbursable costs than it actually has or to represent that all disclosure responsibilities have been fulfilled; or

Fraudulent or illegal reporting and use, including defalcation of commonwealth funds, could result in debarment and legal action. These actions would have a direct and material effect on the financial statement amounts, including a misstatement or a liability to the Commonwealth on the Balance Sheet.

AUDITOR'S COMPLIANCE SUPPLEMENT

ATTACHMENTS

DIVISION OF PURCHASED SERVICES
BUREAU OF AUDIT
AUDIT RISK ASSESSMENT FORM

Contractor Name:_____

Vendor Code Number:_____ **Audit Number:** _____

Area of Testing/Reporting:

_____

In determining materiality and/or significance and audit risk which governs the level of testing required or the inclusion of a potential finding in the report, the auditor must consider the following:

	Risk Level			
Factors to be Considered	**High**	**Moderate**	**Low**	**or %**
a. Amount of revenue and expenditures.	_____	_____	_____	_____
b. Newness of the activity or changes in its condition.	_____	_____	_____	_____
c. Adequacy of internal controls	_____	_____	_____	_____
d. Results of prior audits	_____	_____	_____	_____
e. Level and extent of review or other form of independent oversight	_____	_____	_____	_____
f. Adequacy of the internal controls for ensuring compliance with laws and regulations	_____	_____	_____	_____
g. Management's adherence to applicable laws and regulations.	_____	_____	_____	_____
h. Audit report users' expectations	_____	_____	_____	_____
i. Public perceptions and political sensitivity of the areas under audit.	_____	_____	_____	_____
j. Audit requirements (tests required by audit objectives).	_____	_____	_____	_____

Total risk level developed from above considerations during survey/planning stage of engagement: _____

Level of initial testing required: _____

Revised level of testing developed from initial test: _____

Potential finding included or dropped because of materiality: _____

Selected Sections Of The Executive Office Of Health And Human Services Secretariat Guidelines For The Procurement of Social and Rehabilitative Services

(MM Subsidiary Contracting, Effective January 31, 1992 and Until Further Notice)

Primary/Secondary Procurement Coordination

Provisions for notification of budget information for new programs and amendments to secondary governmental purchasing agencies are set forth at 808 CMR 1.09: (2) (a) and 808 CMR 1.11: (2). For annual budget re-negotiations under 808 CMR 1.07 EOHHS requires that providers and primary purchasing agencies also provide advance notice to known secondary purchasing agencies, so that they can have input in the budget development process . Final responsibility for rate negotiation remains with the primary purchasing agency. Secondary EOHHS purchasing agencies must adhere to the contract provisions established with the primary purchasing agencies.

Cost Reimbursement

EOHHS strongly discourages the use of cost reimbursement procurement, except under certain limited circumstances, as established by 808 CMR 1.06 (3). The cost reimbursement program must be available for purchase exclusively by the governmental unit. This should be interpreted by EOHHS purchasing agencies to prohibit cost reimbursement procurement for programs which receive other support from Medicaid, third party payers, or other governmental and non-governmental unit rate purchasers (excluding client sliding fees, donations/grants, or client resources such as rent payments and food stamps). The billing, under cost reimbursement contracts, of indirect costs or activities which are already indirectly reimbursed through out-patient class rates or similar direct service rates, is also prohibited.

Program Budget Amendments

The following guidance is provided to supplement the guidelines for budget adjustments set forth at 808 CMR 1.11.

For negotiated unit rate contracts, EOHHS purchasing agencies should treat a variance in operating costs or offsetting support which results in a substantial net change to Unit Rate Calculation Page line 3 (Net Reimbursable Adjusted Expense) as a "substantial difference" requiring budget review and amendment where appropriate. The provider is responsible for notifying the purchasing agency and the budget should be amended and the price/.maximum obligation adjusted accordingly.

For cost reimbursement contracts, formal amendments are not required where the maximum obligation is not increased and variances between cost categories (as set forth in applicable Program Budget Form lines) do not exceed ten percent. However, for invoicing and audit trail purposes, all agreed-upon changes to line items should be documented in writing and retained at both provider and purchasing agency offices for subsequent review.

Agencies and providers also should consider executing amendments whenever possible to obviate the need for retroactive recovery action pursuant to 808 CMR 1.19 (3), Non-Profit Maintenance Expense.

The Commonwealth of Massachusetts
Executive Office for Administration and Finance
Operational Services Division
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MEMORANDUM

TO: Interested Parties

FROM: Kent Barkhouse, Director
Bureau of Audit, Division of Purchased Services

DATE: April 24, 1998

RE: Policy Guidance/Regulatory Interpretation of 808 CMR 1.05 (24)
Salaries of Officers and Managers

This memorandum updates and supersedes the last guidance issued by DPS on this subject, dated June 4, 1997.

Effective July 1, 1997, the salaries of officers and managers as defined by DPS shall be non-reimbursable under Division of Purchased Services regulation 808 CMR 1.05 (24) as amended to the extent that they exceed an annual rate of $100,142 Contractors must maintain documentation and justification for the selection of a salary reimbursement rate up to $100,142. Where officers and managers devote less than full time to state programs, the level of reimbursement should be prorated accordingly. See 808 CMR 1.05 (24).

KB: kb

QUESTIONS AND ANSWERS

ON

AUDIT AND PREPARATION OF THE UFR

AUGUST 1994

Division of Purchased Services
Bureau of Audit

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Participants in recent UFR training sessions have raised a number of questions that we will atte to address, regarding audit and administrative issues in the UFR preparation. The follow questions and answers have been prepared from questions frequently asked. The purpose is provide clarification and additional practical working guidance to those participating in purchase of service system. We will be forwarding other clarifications in the future as additio issues are brought to our attention.

1. **Are the Division of Purchased Services (DPS) nonreimbursable cost provisions in regulation 808 CMR 1.15 applicable to programs supported by funding from special education unit rate payments and negotiated unit rate contracts and agreements?**

   Yes: Special education and negotiated unit rates that are utilized for the purchase of social services are subject to the nonreimbursable cost provisions of regulation 808 CMR 1.15. Special education and negotiated unit rates, unlike traditional fee-for-service unit rates such as Medicaid (class rates), are reimbursements for attained performance and resource usage previously identified in an amendable program budget. The fiscal year 1994 UFR Auditor's Compliance Supplement provides extensive guidance concerning the establishment of reimbursement and contractual and regulatory requirements beginning on page 12 in the Suggested Areas of Compliance Testing section.

2. **Why does DPS communicate directly with provider organizations concerning some UFR reporting deficiencies?**

   The UFR Audit and Preparation Manual (KEY CONCEPTS) and DPS training programs have always stressed the respective responsibilities of the independent auditor and management concerning the UFR financial statements and supplemental information. This guidance is consistent with generally accepted auditing standards (GAAS) and generally accepted government auditing standards (GAGAS). These auditing standards provide that preparation of the financial statements and supplemental information is management's responsibility, and the auditor's responsibility is to audit and express an opinion on certain of the financial statements that are considered necessary for presentation of financial position and the results of operations and changes in fund balances in conformity with generally accepted accounting principles (GAAP). Accordingly, issues concerning the reporting of deficiencies related to GAAP, GAAS and GAGAS potentially affecting the opinions and assurances made by the auditor in auditor's reports are referred to the independent auditor. Other reporting issues such as failure to secure appropriate audit services and to prepare or adequately prepare supplemental letters and schedules are referred to the provider.

3. **Do independent auditors from the Office of the State Auditor employ different standards of materiality and significance when conducting and reporting on GAGAS audits than do independent auditors employed by public accounting firms?**

   No: All independent auditors conducting and reporting on GAGAS audits must exercise due professional care (sound judgment) and consider materiality and/or significance as required in the third general standard of the 1988 revision of GAGAS. This care and consideration must be applied when planning the audit and in selecting the methodology and designing audit tests and procedures, as well as in deciding whether a matter requires disclosure in an audit report (similar provisions are contained in the third general standard and field work standards of the 1994 revision of GAGAS, which must be used for UFR audits of periods ending on or after January 1, 1995). The standard indicates that professional judgment must be used in decisions concerning quantitative and qualitative criteria for determining materiality and significance. The materiality level and/or threshold of acceptable risk may be lower in GAGAS audits than similar type audits in the private sector. The professional judgment used in vulnerability and risk assessments employed by governmental independent auditors has traditionally placed great emphasis on qualitative criteria resulting in lower materiality thresholds for selecting methodology and designing audit tests and procedures and deciding whether a matter requires disclosure. These lower materiality thresholds are different from what public accountants are accustomed to (see question 4 for related issue). The fiscal year 1994 UFR Auditor's Compliance Supplement provides further information on pages four through ten concerning materiality/significance and sensitivity and risk and vulnerability assessments in GAGAS audits.

4. **Are there different reporting requirements for internal control and noncompliance deficiencies when performance audit standards of GAGAS are used by governmental agencies like the Office of the State Auditor rather than the financial audit standards of GAGAS that are used to audit the UFR?**

   Recent audits of providers by the Office of the State Auditor have assessed the provider's performance regarding economy and efficiency of operations and attainment of program outcomes. The 1988 revision of GAGAS (yellow book) lists nine examples of the types of issues related to performance audits that the Office of the State Auditor has considered when conducting performance audits of providers as follows: Is the entity following sound procurement practices? is the entity acquiring appropriate type, quality, and amount of resources when needed at the lowest cost? is the entity complying with requirements of laws and regulations that could significantly affect the acquisition, protection and use of the entity's resources? is the entity avoiding duplication of effort by employees and work that serves little or no purpose? is the entity avoiding idleness and overstaffing? is the entity using the minimum amount of resources (staff, equipment, and facilities) in producing or delivering the appropriate

quantity and quality of goods or services in a timely manner? is the entity complying with requirements of laws and regulations that could significantly affect acquisition, protection, and use of the entity's resources? and has the entity an adequate system for measuring and reporting performance on economy and efficiency?

INTERNAL CONTROLS:
The performance audit standards of GAGAS require the Office of the State Auditor to identify any significant weaknesses (generally the importance in relation to a problem the auditor identifies) in the internal controls found during the audit. The field work and reporting performance audit standards of GAGAS require the Office of the State Auditor to review and report on any significant weaknesses in the internal controls for accounting and administrative functions established to ensure economic and efficient performance. The financial audit standards of the yellow book (used for most of the UFR audit) requires that reportable conditions in the entity's internal control structure that are considered material weaknesses or that represent significant deficiencies in the design or operation of the internal control structure must be reported. The yellow book stresses that an understanding of internal controls to ensure compliance with laws and regulations must be obtained. The fiscal year 1994 UFR Auditor's Compliance Supplement highlights many compliance requirements related to items in the suggested area of the compliance testing section beginning on page twelve. Many of these compliance requirements are the same issues that the Office of the State Auditor must review and report on when assessing internal controls in conjunction with a performance audit of a provider's economy and efficiency and performance.

NONCOMPLIANCE: The performance audit standards of GAGAS require the Office of the State Auditor to report all significant instances of noncompliance found during or in connection with the audit, even those not resulting in a legal liability. In addition, the Office of the State Auditor must also report all significant instances of abuse (furnishing excessive services to beneficiaries or performing what may be considered improper practices, none of which involves noncompliance with laws and regulations) as part of the performance audit. Audit findings concerning significant issues of abuse generally note that the abusive condition is not prohibited by law or regulation and recommend that an abusive condition be considered for inclusion into law or regulation. The Office of the State Auditor is required to assess compliance with laws and regulations when necessary to satisfy the audit objectives. The Office of the State Auditor, in accordance with the field work standards for performance audits, would examine compliance with laws and regulations that could significantly affect the acquisition, protection, and use of the provider's resources, and the quantity, quality, timeliness, and cost of the services it produces and delivers when conducting a performance audit of a provider's economy and efficiency and performance.

The 1988 revision of the financial standards of the yellow book that is used for most of the audit of the UFR requires that all material instances of noncompliance related to the entity's financial statements or the program, award, claim, fund, or group of accounts being audited must be reported. In addition, several instances of noncompliance that separately may not be material, but cumulatively could have a material effect on the financial statements must be reported. All material instances of noncompliance related to a program of the UFR must be reported because the statement of functional expenses reports activity by program and it is a basic financial statement of the UFR. Further, the field work standards of the 1988 revision of the yellow book also indicate that the auditor must assess the risk of noncompliance with laws and regulations occurring and having a direct and material effect on the financial statements. The field work standards of the 1994 revision of the yellow book, which must be used for UFR audits of periods ending on or after January 1, 1995, extend these provisions to include material indirect effect on the financial statements. The new 1994 revision also includes an additional standard that the audit is designed to provide reasonable assurance of detecting material misstatements resulting from noncompliance with provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts. The fiscal year 1994 UFR Auditor's Compliance Supplement highlights many compliance requirements, in the Suggested Area of Compliance Testing section beginning on page twelve, that could have a material effect on the UFR financial statements that include the programs reported in the statement of functional expenses. Many of these compliance requirements are the same issues that the Office of the State Auditor reviews and reports on when examining compliance with laws and regulations that could significantly affect the acquisition, protection, and use of the provider's resources, and the quantity, quality, timeliness, and cost of the services it produces and delivers as part of a audit of a providers economy and efficiency and performance.

5. **Should any of the performance audit standards of GAGAS be followed when conducting an audit of the UFR?**

Chapter two of the 1988 and 1994 revision of the yellow book indicates that auditors should follow the standards that are applicable to the individual objectives of the audit. Audits may have a combination of financial and performance audit objectives or may have objectives limited to only some aspects of one audit type. For example, auditors conduct audits of government contracts and grants with private sector organizations, as well as government and nonprofit organizations, that often include both financial and performance objectives. The reporting standards for financial audits of GAGAS concerning reporting on noncompliance and internal controls indicate that in presenting the findings, the auditor must follow the report content and presentation standards of the performance audit standards for reporting, as appropriate. The applicable sections of these standards are as follows: **report contents standards** - objectives, scope, and

methodology, audit findings and conclusions and cause and recommendation (audit results), and views of responsible officials; **report presentation standard** - complete, accurate, objective, convincing, clear and concise. This requirement includes all of the reporting standards for performance audits except for the requirements concerning statement on auditing standards, internal controls, compliance with laws and regulations and the report distribution standards. It may be necessary to follow certain field work standards for performance audits while conducting an audit of the UFR in that many of the regulatory and contractual requirements relate to economy and efficiency and performance issues that may have a direct and material effect on the determination of financial amounts in the financial statements. Economy and efficiency and performance issues are generally related to performance audit activity and the standards for performance audits rather than to financial statement audits. The 1994 UFR Auditor's Compliance Supplement provides guidance and criteria concerning many of these regulatory and contractual requirements that could have a direct and material effect on the financial statements. The audit objectives concerning requirements associated with economy and efficiency and performance may require, as appropriate, that the planning, legal and regulatory requirements, internal control and evidence field work standards for performance audits be followed.

6. **What would the end-of-the-year entry for surplus revenues that are subject to the DPS Not-for-Profit Surplus Revenue Retention Policy be?**

   The provider should follow the customary practice of transferring the surplus funds to the unrestricted fund balance at the end of the year. Surplus funds that are under the 5 % threshold must be segregated from the funds that are over 5 % (and which are subject to recoupment) in the fund balance. Segregating the funds permits the provider to report the accumulated value of the surplus funds under the threshold as the surplus fund pool in the notes to the financial statements, and the surplus funds over the threshold as a liability to the Commonwealth on the balance sheet.

7. **What is considered adequate evidence for the questions asked about the independent auditor on the UFR Audit Services Checklist & Certification?**

   A positive statement in a letter from the auditor affirming that the auditor has met all the training requirements, experience and qualifications noted in the checklist is considered adequate evidence.

8. **Are employees of provider organizations that are related by family relationship to members of the provider's board of directors considered related parties?**

   No: Related party transactions and relationships, as governed by DPS regulations. are transactions made between the provider and directors, stockholders and external individuals and entities. Provider employees are considered internal individuals and are not subject to the DPS related party provisions; though, a related party relationship would exist if the transaction related to a situation where the employee is acting as a representative of an external entity or as an independent contractor or consultant. However, potential conflict of interest and nepotism situations could exist when employees that set policy and are in a position of responsibility are related to board members. Nepotism is not in keeping with the principles for good internal controls.

9. **Does DPS charge a fee for attending UFR training sessions?**

   No: A fee has never been charged for a DPS UFR training session. However, DPS is considering, in conjunction with other organizations, conducting future training sessions at a commercial facility and providing a light lunch. This of course would require DPS to charge a fee to defray costs for providing these additional amenities.

10. **What procedures should be followed when surplus funds are accrued in a cost reimbursement contract?**

    Cost reimbursement is defined as: A payment arrangement under which the purchasing agency reimburses the provider for budgeted costs actually incurred in rendering the services specified in the agreement, up to a stated maximum obligation. State France law does not permit provider organizations to retain any portion of surplus funds generated through overbilling in cost reimbursement contracts. This provision also prevents purchasing agencies of the Commonwealth from establishing any method of resolution other than a scheduled repayment plan to recover surplus funds in a cost reimbursement contract. The DPS Audit Resolution Policy indicates that when expenses are undocumented in cost reimbursement contracts, other evidence, in the form of alternate documentation, cannot be considered and recovery of funds is appropriate as a basis of resolution. To avoid overbilling in cost reimbursement contracts, providers should reconcile any payments made for budgeted expenses with the actual expenses incurred before submitting the final payment voucher for the year. The last month's billing can then be adjusted accordingly and no surplus funds will remain that would be subject to an audit finding. The independent auditor should, as part of the tests on compliance with laws and regulations and internal control, write an audit finding in the report on compliance when overbilling is detected and write a finding in the report on internal control concerning the material weakness that permitted the overbilling to occur.

11. **What procedures should an independent auditor and provider follow when state or federal nonreimbursable costs are incurred in a program that is subject to DPS reimbursement provisions and the provider does not have an adequate level of unrestricted or donor restricted revenues that was earned in prior reporting periods, borrowed funds or revenues not derived from public funds to defray the nonreimbursable costs?**

    The independent auditor should, as part of the tests on compliance with laws and regulations and internal control, write an audit finding in the report on compliance if overbilling is detected because support that does not include public funds was not available to defray nonreimbursable costs, and a finding in the report on internal control should also be written concerning the material weakness that permitted the overbilling to occur. The provider should report on schedule B-1 of the UFR that there was no support, not derived from public funds, available to defray the nonreimbursable costs and work with Commonwealth purchasing agencies to adequately resolve the overbilling and internal control findings using the DPS Audit Resolution Policy.

12. **What appeal process or input does the provider have when the Office of the State Auditor or the providers' independent auditor writes a compliance or internal control finding that the provider does not agree with?**

    All audits of the Office of the State Auditor and all audits of the UFR, that contain findings, are conducted in accordance with GAGAS. These standards require that sufficient, competent, relevant evidence must be obtained to afford a reasonable basis for the auditors' judgments and conclusions regarding the provider, program, activity, or function under audit. The provider has the ability to provide the independent auditor representing the Office of the State Auditor with any available evidence to modify or change the auditor's judgments and conclusions. In addition, the standards also require that the auditor's report include the pertinent views of responsible officials of the provider (usually in the finding) concerning the auditor's findings, conclusions, and recommendations, and what corrective action is planned.

    Further, the standards also require that audit reports are to be submitted by the audit organization to the appropriate officials of the provider and to the appropriate office of the organization requiring or arranging for the audit (at times DPS and state purchasing agencies). Copies of the reports must also be sent to other officials who have legal oversight authority or who may be responsible for taking action. For purchase of service related issues, state purchasing agencies have primary responsibility for taking action and DPS has oversight responsibility. The DPS Audit the Resolution Policy has been established pursuant to this oversight responsibility and the need for DPS to adhere to

the standards of GAGAS. All audits by independent auditors from the Office of the State Auditor, federal government and public accounting firms auditing the UFR of provider organizations that receive state or federal funding from the Commonwealth must be resolved using the DPS Audit Resolution Policy. This policy requires the provider's principal purchasing agency (PPA) of the Commonwealth to enter into a written corrective action plan (CAP) to resolve the deficiencies related to the purchased services. The PPA must-review the audit findings (resulting from testing and reporting compliance with the existing standards in the auditor's reports) containing the provider's views and any additional views (the provider organization's response to auditor's report in the UFR) or evidence furnished by the provider that could potentially affect the finding prior to resolving the finding. Any additional evidence furnished by the provider to the PPA must be evaluated for sufficiency and relevance to the findings. Prior to the PPA making a resolution determination concerning the finding, the PPA must also furnish the independent auditor with the additional evidence for the purpose of determining if the auditor's judgments and conclusions should be modified or changed.

13. What responsibility does a provider and its independent auditor have concerning surplus funds accrued through social service contracting with the Commonwealth prior to fiscal year 1993?

The Commonwealth's Surplus Revenue Retention Policy for unit rate contracting will administratively commence by utilizing the fiscal year 1993 UFR. Surplus revenues accrued in programs receiving Commonwealth unit rate funding prior to fiscal year 1993 will not be analyzed. Providers that have been carrying a liability to the Commonwealth as a result of unit rate contracting may write off the liabilities. Surplus revenues through cost reimbursement contracting with the Commonwealth, regardless of when they were accrued, must be treated as a liability to the Commonwealth and are subject to recoupment. The independent auditor should follow the guidance in question 10 above concerning testing and reporting on compliance with laws and regulations for overbilling in a cost reimbursement contract if the provider has disclosed in the notes to the financial statements a liability to the Commonwealth derived from surplus funds accrued in cost reimbursement contracts.

14. Does the bureau of audit utilize the telephone to notify providers and independent auditors about UFR filing deficiencies or to provide UFR filing guidance?

Yes: The bureau of audit attempts to notify providers and independent auditors about deficiency items requiring limited explanation over the telephone. Staff of the bureau of audit spend a substantial portion of their work day providing guidance on the telephone to providers and independent auditors concerning issues related to the fling requirements of the UFR.

15. Why is it that no opinion is rendered in the independent auditor's reports of performance audits conducted by the Office of State Auditor in accordance with the performance standards of GAGAS?

Generally, at the completion of a performance audit the auditor does not express an opinion on the overall performance of the provider; therefore, the performance audit standards of GAGAS do not contemplate that the auditor will be called upon to give such an opinion. Rather, the auditor would report findings and conclusions on the extent of adequacy of performance, and on specific processes, methods, and internal controls (including compliance with laws and regulations) that can be made more efficient or effective. If potential for improvement is found, the auditor would recommend appropriate corrective action.

Additional questions are welcomed by DPS. Questions may be forwarded to the Director, Bureau of Audit at the following address:

Executive Office for Administration & Finance
Department of Procurement & General Services
Division Of Purchased Services
One Ashburton Place, Room 1017
Boston, Massachusetts 02108

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ADDITIONAL QUESTIONS AND ANSWERS ON AUDIT AND PREPARATION OF THE UFR FOR PROVIDERS AND INDEPENDENT AUDITORS

MAY 1995

Division of Purchased Services
Bureau of Audit

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This is the second installment of commonly asked questions and answers concerning the audit and preparation of the Uniform Financial Statements and Independent Auditor's Report (UFR)..As was the case with the August 1994 publication of Questions and Answers, the purpose of this document is to provide answers to commonly asked questions and additional, practical guidance to individuals working in the purchase-of-service system. While this document will assist in the preparation and audit of the UFR it also should help providers in making decisions relating to their operations. We will be forwarding additional information in the future as issues are brought to our attention.

1. What are the most common UFR filing deficiencies?

The most common UFR filing deficiencies are the deficiencies classified as ***minimum filing deficiencies.*** Minimum filing deficiencies are failures to meet the minimum filing requirements of the Division of Purchased Services (DPS) and the provisions of OMB Circular A-133, if applicable. Filings containing these deficiencies require correction by the provider and/or independent auditor and resubmission of one or more statements, schedules or reports. Examples of the types of deficiencies in this category include failure to meet the items noted in the UFR Preparation and Audit Checklist that is included in the 1994 UFR Audit and Preparation Manual as follows:

- One or more of the following elements of the UFR have not been filed as required:
    - ◊ UFR Cover Page (must always be filed)
    - ◊ Auditor's Reports (at least 3 for audited Financial Statements and I for reviewed Financial Statements)
    - ◊ Balance Sheet
    - ◊ Statement of Revenue and Expenses and Changes in Fund Balances
    - ◊ Statement of Functional Expenses

- ◊ Notes to the Financial Statements
- ◊ Schedule of Federal Financial Assistance and appropriate OMB Circular A-133 Auditor's Reports (if required)
- ◊ Board of Directors' Acknowledgment Letter

- OMB Circular A-133 audit was not conducted when required.
- Audit was not conducted in accordance with generally accepted government auditing standards (GAGAS).
- Supplemental information paragraph was not included in Independent Auditor's Report or separate report as required by Auditing Standards SAS 29 and 52.
- Independent Auditor's Reports did not meet reporting standards of Generally Accepted Auditing Standards.
- Information in supplemental schedules does not reconcile and is not in agreement with the basic financial statements.
- Independent auditor did not opine, when required, on the Statement of Functional Expenses.
- Financial statements were not prepared in accordance with the AICPA Audit Guide for Voluntary Health and Welfare Organizations, as required by 808 CMR 1.00 and General Conditions of the Master Agreement.
- Administration (Management and General) costs were not reported in the administration column but rather in the program columns as direct program costs.
- Full-tine Equivalents (FTEs) were not reported as required.
- The program number that was used on the Service Contract cover page and the Attachment B program budget was not used consistently for reporting program activity in the UFR.
- UFR Audit Services Checklist & Certification Form was not completed by the provider and filed along with the UFR.

- The appropriate representative of the provider's independent auditor of the UFR did not attend the filing year's UFR training session.
- The auditor's management letters containing nonreportable conditions in the internal control structure and nonmaterial instances of noncompliance that were referred to in the Auditor's Reports on Internal Controls and Compliance were not submitted along with the UFR.
- All of the UFR Lotus disks were not completed and returned or an approved waiver request was not returned along with the UFR.

Other types of deficiencies are **considered *significantly inadequate or substandard*** filings. These filings include repeated failures to comply with the minimum filing requirements of DPS and OMB Circular A-133. They also include filings containing deficiencies that make the financial statements, schedules and reports unusable for fulfilling one or more of the objectives of financial statements and audits conducted in accordance with generally accepted government auditing standards.

Filings in this category have significantly failed to comply with applicable accounting principles and auditing standards. These filings are not considered received by DPS until the filing has been corrected by the provider and/or independent auditor and, as a result, the provider is deemed to not have met its filing requirements. Filings categorized as significantly inadequate or substandard may not be considered as adequate for meeting contract prequalification requirements and are not available to the general public. Significantly inadequate or substandard filings may warrant a Quality Control Review of the auditor's reports and workpapers or formal referral to other appropriate regulatory agencies and/or professional societies.

2. How should surplus revenues calculated pursuant to 808 CMR 1.19 (3) and the DPS Not-for-Profit Provider Surplus Revenue Retention Policy be recorded in the provider's accounting records and disclosed in the UFR?

UFR report users and practitioners have asked that we consolidate and further explain previously furnished information concerning appropriate recording and disclosure of DPS not-for-profit provider surplus revenue retention revenue. This answer consolidates and further explains information previously furnished by DPS in the following publications: Question number six (6) of ***Questions and Answers on Audit and Preparation of the UFR, issued August 1994***, and question number ten (10) of the ***Revised Policy: Not-for-Profit Provider Surplus Revenue Retention Pursuant to 808 CMR 1.19 (3), issued August 31, 1994***. See also 808 CMR 1.08 effective January 27, 1995. UFR report users and practitioners should be aware that some information previously furnished in these questions, which continues in effect, has not been included in the following consolidated answer.

The provider needs to take the following steps:

- Make an entry in a segregated unrestricted fund balance account of the provider's books of account at the end of the year.
- Disclose an ***accounting estimate*** (see AICPA Statement on Auditing Standards No. 57) of the beginning and ending balances and results of changes in the surplus revenue retention fund pool in the Notes to the Financial Statements.
- Disclosure of the activity of the surplus revenue retention fund pool in the Notes to the Financial Statements needs to identify how the prior year's surplus revenues were used by identifying the functional and natural classification (example administration/occupancy cost) of the reimbursable costs defrayed with the revenues (see question 5 for related guidance).

- If the provider accumulated a surplus in excess of the 5% threshold for the current year, or if the cumulative amount of the provider's surplus account exceeds 20% of the prior year's revenues from purchasing agencies, the following must occur:
- A liability, due to the Commonwealth, must be recorded and disclosed in the provider's books of account and financial statements of the UFR, respectively.

The Notes to the Financial Statements must disclose how the provider and the Commonwealth have agreed the liability, due to the Commonwealth, will be or has been met, e.g., Purchasing Agency has negotiated a lower rate.

3. **What are some of the financing requirements of the Commonwealth's purchase-of-service** (POS) **system that affect the use of surplus funds under 808 CMR 1.19 (3) and the Not-for-Profit Surplus Revenue Retention Policy?**

The surplus revenues retained by providers are ***public revenues*** and therefore their use is limited in the following manner:

- The revenues may only be expended for activities and programs that are in keeping with the **Massachusetts charitable** purposes of the provider organization.
- The revenues may not be spent on items that are prohibited by state or federal law and regulation, such as non-reimbursable state and federal costs set forth in 808 CMR 1.15, including depreciation expense for the purchase of capital items (except free care).

4. Is it possible to apply Commonwealth surplus revenue subject to the provisions of 808 CMR 1.00 to program deficits incurred in prior years?

Yes and No:

Yes: Net surplus/deficit revenue of 5 % or less may be retained by the provider and used from year to year to off-set deficits. The surplus/deficit revenue must be maintained in a segregated unrestricted fund balance to be used for off-setting deficits related to the charitable purpose of the provider.

No: Net surplus revenue in excess of 5% is subject to recoupment and must be reported as a liability due to the Commonwealth. This surplus revenue must be used to liquidate the liability due to the Commonwealth rather than to reduce prior years' deficits. However, the purchasing agency may at times find that it is in the Commonwealth's best interest to apply the surplus revenues to prior year deficits and approve such actions. Such a determination would be made by the purchasing agency on a case by case basis.

As noted in the surplus revenue retention policy-and-in 808 CMR 1.08 (1) (e), there are four options to reduce the liability of excess surplus revenue due to the Commonwealth as follow:

1) The Purchasing Agencies may enter into an agreement with the provider which would stipulate the use of excess funds.
2) DPS or the Purchasing Agencies may request that the excess funds be returned to the Commonwealth.
3) Future prices set by DPS or negotiated by Purchasing Agencies may be reduced.
4) If a Chapter 71B program, the price set for the program may be adjusted pursuant to 808 CMR 1.08 (1) (e).

5. **How will the Commonwealth determine that the *public revenues* derived from the surplus revenue retention fund pool were appropriately spent for purposes net-prohibited by state and federal non-reimbursable cost provisions?**

   The Notes to the Financial Statements of the UFR must identify, through a disclosure, the dollar amount of surplus revenues retained that were 5 % or less of the amount of revenues that may be retained pursuant to the Surplus Revenue Retention Policy. The disclosure must also specifically identify the reimbursable costs that were defrayed with these ***public revenues*** in the subsequent years following the retention of the surplus revenues. In addition, providers are responsible for disclosing the existence of revenues that are used to defray non-reimbursable costs associated with programs funded by the Commonwealth in Schedule B-1 of the UFR. The DPS Bureau of Audit reviews Schedule B-1 to ensure ***that public revenues*** (surplus revenue retention fund pool revenues are public revenues) were <u>not</u> used to defray nonreimbursable costs. Furthermore, the Auditor's Report on Compliance with Laws, Regulations, Contracts and Grants Based on an Audit of the UFR Financial Statements Performed in Accordance with Generally Accepted Government Auditing Standards (GAGAS) will provide the Commonwealth with an additional level of assurance concerning compliance with the provisions of the Not-for-Profit Surplus Revenue Retention Policy.

6. **Is unrestricted administrative revenue and Commonwealth Capital Budget revenue that is disclosed and allocated to programs in Supplemental Revenue Schedule A of the UFR subject to the Surplus Revenue Retention Policy?**

   No: The intent of the Surplus Revenue Retention Policy is to exclude revenue derived from a Commonwealth Capital Budget Contract and unrestricted administrative revenue reported in Supplemental Schedule A from the calculation. The Surplus Revenue Retention Policy will be modified to explicitly indicate that these revenues should not be used in the

calculation of surplus revenue subject to the Surplus Revenue Retention Policy. The previously issued Revised Policy: ***Not-for-Profit Surplus Revenue Retention Pursuant to 808 CMR 1.19(3) Questions and Answers, DPS Publication Number: DPS-PO38A-93*** will be revised in Question 8, "What formula will DPS use to determine a surplus?" as follows: ***(Changes have been emphasized with italic bold print)***

For purposes of implementing 808 CMR 1.19(3), the annual surplus under review is limited to Commonwealth funds, including funds from cities and towns for special education programs, ***and excluding Commonwealth funds from Capital Budget contracts***. DPS will use the financial information documented in the UFR as reported in Supplemental Schedules A and B. DPS will determine the amount of Commonwealth revenue supporting the provider on a program-by-program basis (total of lines 7, 8, 11, 16-20 (a&b), 22-31 (a&b) and 34 on Schedule A, currently: Supplemental Revenue Schedule). Next, an Adjusted Total Revenue will be calculated by subtracting the sum of Unrestricted Revenue **funds** ***plus revenue from a Commonwealth Capital Budget Contract(s)*** (currently, lines 1, 4, 13, 42, 45, 48, 51, ***57 and a line to be designated*** on Schedule A: Supplemental Revenue) from Total Revenue (currently, line 58 Schedule A: Supplemental Revenue Schedule) for each program. Then the percentage of Commonwealth Revenue will be determined by dividing the Total Commonwealth Revenue by the Total Adjusted Revenue for each program. Total of Unrestricted Revenue and Commonwealth ***Capital Budget Revenue*** will then be subtracted from line 47, Excess/Deficit Support Over Expense, Schedule B: Supplemental Expense Schedule. This will yield an adjusted surplus/deficit.

The adjusted surplus/deficit is then multiplied by the percentage of revenue attributable to the Commonwealth. This will yield the total surplus/deficit attributable to the Commonwealth for the program. DPS will then calculate a grand total for the Commonwealth revenue ***(which will not include revenue from Capital Budget Contracts)*** and a grand total for the allocation of Commonwealth surplus and deficit from the sum of all of the programs. The percentage of the surplus/deficit allocated to the Commonwealth is calculated by dividing the grand total of the Commonwealth surplus/deficit by the grand total of the Commonwealth

revenue. If this percentage is less than or equal to five percent, then the provider may retain the funds pursuant to 808 CMR 1.19 (3).

Although cost reimbursement funds are included in the formula for the determination of total funds, it is a violation of state finance law for Commonwealth cost reimbursement contracts to accumulate surpluses. Any surplus attributable to or generated by Commonwealth-related income and expenses in cost reimbursement contracts will be subject to recoupment.

7. **Whose responsibility is it to calculate the Commonwealth Surplus/Deficit Revenue Retention amounts?**

   It is management's responsibility to calculate the estimated surplus revenue that is subject to the Surplus Revenue Retention Policy. In addition, it is also management's responsibility to record the excess surplus revenue as a liability, due to the Commonwealth, if applicable. Management's calculations are subject to challenge by a final calculation conducted by the Pricing Bureau of DPS as is necessary. Generally, final calculations conducted by DPS will not be forwarded to the provider unless it is determined that the amount reported in the Notes to the Financial Statements by management may have been in error. To facilitate the calculation for Fiscal Years ending on or after June 30, 1995, a template will be furnished to the provider for use in calculating the amount of the Surplus/Deficit Revenue Retention and the amount of excess Surplus Revenue Retention Revenue that must be reported as a liability due to the Commonwealth.

8. **May *client resources* or *third-party payments* furnished to a provider on behalf of a client for services furnished in a Commonwealth-funded program be used to defray state and federal non-reimbursable costs?**

   No: The provisions of 808 CMR 1.18, applicable to all providers, and the POS contract forms and instructions issued pursuant to 808 CMR 1.07 require client resources or third-party payments when made on behalf of a client to first be used by the provider to reduce the amount of the

appropriate purchasing agency's obligation for the service rendered to the client (please note that the maximum financial obligation of the purchasing agency does not include non-reimbursable costs pursuant to 808 CMR 1.15).

Further, the provisions of 808 CMR 1.18 also require that even if client resources or third-party payments made on behalf of a client are not expressly recognized or anticipated in the program budget or otherwise in the computation of the price, the amount of the resources or third-party payments actually received shall be used to reduce the allowable costs related to the purchasing agency's obligation for client services. The reduction in the purchasing agency's obligation may occur in a number of ways, including but not limited to, through price adjustments carried out through contract amendment under 808 CMR 1. 11, administrative reviews pursuant to 808 CMR 1.14 and audit. The most frequently used mechanism to reduce the purchasing agency's financial obligation that occurs because the provider has received unanticipated client resources or unanticipated third-party payments is through offsets to invoices (reduced billings) submitted to purchasing agencies. In addition, it should be noted that 808 CMR 1.18 also specifically prohibits a provider from charging more to a Commonwealth-funded client than the approved rate. The regulation states, in part, the following: ***Each provider shall as a condition of acceptance of payment made by one or more purchasing agencies for service provided, accept the program's authorized price, as established by the Division, pursuant to 808 CMR 1.00, as full payment and discharge of all obligations for the services provided. There shall be no duplication or supplementation of payment from sources other than those expressly recognized or anticipated in the computation of the price.*** The use of client resources or third-party payments to defray nonreimbursable costs in Commonwealth funded programs would also violate these provisions.

The federal government has similar regulatory provisions that require program income to be used in a certain manner. For federal purposes, program income consists of earnings from federally supported activities, i.e., income from service fees (including client resources), sales of commodities or fabricated items, usage or rental fees, interest on loans

made with federal award funds and royalties on patents and copyrights, etc. (A full definition of program income may be found in OMB Circular A-110, Section-.2 Definitions (x).)

OMB Circular A-110 further provides that program income may only be used in the following ways:

1) Program income must be used as a deduction from total allowable program costs for determining the net allowable costs on which the federal share of the cost is based.

2) If permitted by the federal awarding agency in the terms of the federal award (usually only occurs in federal awards received directly from the federal government), such income may instead be used to further eligible program objectives.

3) If permitted by the federal awarding agency in the terms of the federal award (usually only occurs in federal awards received directly from the federal government), such income may instead be used to finance the nonfederal share of the program (cost sharing or matching requirements).

Client resources and third-party payments made on behalf of clients in a federally funded program are considered program income (service fees) of the program (the usage provisions of program income may be found in OMB Circular A-110 Section -.24 Program Income).

9. What are the testing, reporting and management responsibilities for the independent auditor, provider and the Commonwealth when client resources or third-party payments made on behalf of a client are part of a federal and/or Commonwealth funded program?

The independent auditor should test for the proper use of client resources and third-party payments in a federally funded program as part of the

program income compliance requirements and suggested audit procedures included in the OMB Circular A-133 Compliance Supplement under the "Administrative Requirements," part of "General Requirements"(*used to reduce federal share of costs, see question number 8 for compliance requirements).* The provisions of OMB Circular A-133 require the independent auditor to test and report on internal controls that the provider must have to ensure proper accountability for program income (OMB Circular A-1 10).

The independent auditor must also test for the proper use of third-party payments and client resources furnished on behalf of the client in programs funded by the Commonwealth as part of the auditor's test for the provider's compliance with laws, regulations and contract compliance *(used to reduce Commonwealth maximum obligation, see question number 8 for compliance requirements).* In addition, the auditor's objectives when testing for compliance with record keeping, maintenance and use of client resources and custodian funds, as noted in the suggested areas of compliance testing of the UFR Auditor's Compliance Supplement and purchasing agency policies and regulations, is to determine if the provider has met its fiduciary responsibilities concerning client resources and funds.

The following steps must be taken to report and act upon noncompliance concerning client resources and third-party payments by the independent auditor, the provider and the Commonwealth:

- The reporting standards of the 1994 Revision of GAGAS require auditors to report the results of these tests on client resources and third-party payments in the report on the financial statements or in a separate report if, based on evidence obtained, it is determined that a material irregularity *(intentional misstatements or omissions of amounts or disclosures in financial statements)* or illegal act has occurred or is likely to have occurred.

- Independent auditors must report noncompliance concerning client resources and third party payments that is material to the financial statements in the auditor's report on compliance and internal control.

- When independent auditors detect irregularities, illegal acts or noncompliance that are not material, they should communicate those findings in a management letter to the top management of the provider.

- The provider's management is responsible for taking timely and appropriate steps to remedy irregularities or illegal acts.

- Independent auditors are required by GAGAS to report irregularities or illegal acts directly to parties outside of the provider in the following manner, when circumstances occur, as follows:

    ◊ When an irregularity or illegal act involves assistance received **directly or indirectly from a government agency** (example, Supplemental Social Security Income (SSI)), auditors may have a duty to report directly to the government entity if management fails to take remedial steps.

    ◊ If the independent auditor concludes that such failure is likely to cause the auditor to depart from the standard report on the financial statements or resign from the audit, then the auditor should communicate that conclusion to the provider's governing board.

    ◊ If the provider does not report the irregularity or illegal act as soon as practical to the government entity that provided the government assistance, the auditors should then report the irregularity or illegal act directly to that government entity.

- DPS is also required to follow the GAGAS guidance noted above by reporting the existence of irregularities or illegal acts to other government agencies as appropriate.

10. How should the provider treat revenue that is restricted because it was received from the Commonwealth to purchase capital items under a Capital Budget Contract?

The treatment of this revenue will change when Financial Accounting Standards Board (FASB) Statement No. 116 and No. 117 become effective in the future. Question number 11 below provides guidance on this issue under the new FASB No. 116 and No. 117. This answer addresses the issue under current standards.

Currently, *when an item is purchased under a Capital Budget and the provider is reimbursed,* the restriction is satisfied. The revenue should be recognized in a custodial fund when the asset is purchased and the asset should be recorded and depreciated in accordance with 808 CMR 1. 19. Assets purchased under a Commonwealth Capital Budget Contract are similar to costs incurred under a cost reimbursement contract in that all of the funds will be spent. Unlike a cost reimbursement contract however, the Capital Budget revenue has no offsetting expense except an appropriate value of non-reimbursable depreciation each year. Under current GAAP, the revenue should be recorded in a custodial fund rather than in programs. This will ensure that the revenue will not be included in the calculation of surplus revenue subject to the Surplus Revenue Retention Policy.

11. How will the treatment of revenue that was received from the Commonwealth to purchase capital items under a Capital Budget Contract change with the Implementation of FASB No. 116 and No. 117?

Under the new FASB No. 117, *the revenue should be recognized as current unrestricted revenue in a custodial fund when the asset is purchased.* By having a separate classification/group within the current unrestricted classification, the reader of the financial statement will be able to easily analyze the increase in revenue. The Supplemental Revenue Schedule A will have a separate line for revenue derived from Commonwealth Capital Budget Contracts. Commonwealth Capital Budget Revenue will not be subject to the Surplus Revenue Retention Policy.

This new treatment will assist the provider in meeting its fiduciary responsibilities for Commonwealth assets, along with meeting the reporting requirements of GAAP, which require that purchases that have a future economic benefit beyond one year to be capitalized and depreciated over a certain time period. In addition, the provisions of FASB No. 1 1 6 indicate that the revenue should not be recorded in a temporarily or permanently restricted class as these classifications are restricted for donations.

12. Should non-reimbursable program costs be classified and disclosed as a separate cost category in a supporting service (such as Non-Program), or in a separate program, and are there audit Implications if they are?

No: All costs, whether reimbursable or non-reimbursable, associated with programs or supporting services *(administration, fundraising, and non-program (non-charitable) activities are supporting services)* should be classified and reported in the program or supporting service that they relate to. Reporting non-reimbursable costs related to a program activity in a supporting service (such as Non-Program) as a separate cost category or program is not in keeping with generally accepted accounting principles (GAAP).

Reimbursable and non-reimbursable costs should be categorized and allocated to, the programs or supporting service (such as non-program and fund-raising) that they were incurred in, irrespective of any other source of funds that may be available in other programs or supporting service to defray these costs.

Often, non-reimbursable costs are inappropriately reported in a separate cost category or program when a provider does not have an adequate level of non-public funds available in the program, or in other programs, or in supporting services, to defray the nonreimbursable costs. Contributing to this issue is the requirement that the fund balance of the Surplus revenue retention fund pool may not be used to defray non-reimbursable costs because the balance in this account was derived from public funds.

Misclassification of expenses is not in keeping with GAAP (the use of GAAP is mandated by the General Conditions of the Master Agreement) which would require the independent auditor to determine if the misclassification constitutes a reportable condition that should be included in the auditor's reports on internal controls and compliance or a management letter. If the provider has materially misclassified expenses in the financial statements, the independent auditor may need to express a qualified or adverse opinion in the auditor's report and provide information about the misclassified expense that was not disclosed in the financial statements. This would occur as part of the auditor's obligation to consider whether the particular matter concerning the misclassification should be disclosed in light of the circumstances and facts of which the auditor is aware at the time, as required by the AICPA Statement on Auditing Standards No. 32, to determine if management has omitted information that is required by generally accepted accounting principles. In addition, if the misclassification occurred because there were no nonpublic sources of support available to defray the non-reimbursable costs, the independent auditor is obliged to consider this as an overbilling deficiency which would be subject to inclusion in the auditor's reports on compliance and internal control (see question 11 in Questions and Answers on Audit and Preparation of the UFR, issued August, 1994, for further clarification).

13. How should non-reimbursable costs be disclosed in the UFR?

Non-reimbursable costs must be reported in the program, or supporting service, (i.e., fund-raising or non-program activities), in which they were incurred. Non-reimbursable costs that were incurred in state or federally funded programs must be reported in Supplemental Schedule B on line 43 and/or line 44. Administrative non-reimbursable costs must be distributed to programs or supporting services on line 44a. In addition, the Supplemental Itemized Non-Reimbursable Cost Schedule B-1 must be used to itemize and identify the non-reimbursable costs and the source of nonpublic funds that were used to defray the non-reimbursable cost.

14. Why Is depreciation on assets furnished under a Commonwealth Capital Budget Contract considered a non-reimbursable cost?

The provisions of a Commonwealth Capital Budget Contract recognize that assets purchased with revenues from the contract will be owned by the Commonwealth. Other assets that are purchased with revenues not derived from a Commonwealth Capital Budget Contract (such as revenues from the surplus revenue retention fund pool or revenues derived from non-Commonwealth sources) are owned by the provider and their related depreciation expense is reimbursable. Reimbursing the provider for depreciation of an asset furnished under a Commonwealth Capital Budget Contract would allow the provider to be reimbursed for something it did not pay for and would result in the Commonwealth paying for the asset more than once. Nevertheless, the non-reimbursable depreciation associated with the asset should be reported by the provider to permit the UFR report user to associate the basic value of the asset over a period of time, usually the life of the asset with current revenues.

The depreciation should be reported on Supplemental Itemized Non-Reimbursable Cost Schedule B-1. The obligation to report funds not derived from state and federal sources to offset non-reimbursable cost of depreciation from Capital Budget Contracts with the Commonwealth will be met by indicating on the Schedule B-1 that the depreciation and the offsetting revenue was derived from a Commonwealth Capital Budget Contract (in essence, no off-setting revenue is necessary).

15. May employee bonuses, the purchase of flowers and other similar costs incurred in Commonwealth-funded programs ever be considered reimbursable state or federal costs?

Yes: The reimbursable and non-reimbursable cost provisions of DPS regulations and federal OMB Circular A-122 indicate that under certain circumstances these costs may be reimbursable. Reimbursable operating costs (808 CMR 1.02) must be reasonably incurred or expected to be incurred in the provision of program services purchased by the Commonwealth and not excluded from reimbursement by 808 CMR 1.15.

The concept of reasonableness as it relates to reimbursement is discussed in the DPS Summary Sheet "Reimbursable and Non-Reimbursable Operating Costs," document number DPS-A035-93, dated August 1993. Operating costs in federally supported programs (including administration costs allocated to the program for reimbursement) must meet the general tests of allowable costs by being reasonable and allocable as shown in Attachment A of OMB Circular A-122.

Employee bonuses, flowers, house publications, recreational activities, health, first-aid clinics, employee counseling services as well as other costs associated with the provider's employee morale, health, and welfare activities that are incurred as part of an established practice and custom for the improvement of working conditions, employer-employee relations, employee morale and employee performance may be allowable, or considered reasonable, as follows:

- The provider's employee morale, health and welfare activities must be incorporated into the provider's written policies and the activities must have been expected and must not have been disapproved by the purchasing agency or DPS (if the provider is a Chapter 71B Approved Private School). Prior notice of the expected activities must be furnished to the purchasing agency or DPS (if the provider is a Chapter 71B Approved Private School) through the program proposal review process, award or renewal of the contract, through the program price approval process, or by separate notification prior to the expenses being incurred. In the latter case, the purchasing agency or DPS may disapprove the expense by written notice.

- The costs associated with the employee morale, health and welfare, activities are not considered excessive or unreasonable as defined in 808 CMR 1.15 (1) or, if federally supported, are considered allowable as shown in Attachment A and Attachment B (11) of OMB Circular A-122.

- Providers that utilize a purchase of service contract for contracting with the Commonwealth must include the costs

associated with the employee morale, health and welfare, activities as budgeted Administrative Support, Direct Care or Occupancy costs in Attachment B.: Fiscal Conditions/Program Budget of the purchase-of-service contract.

- The provider's employee, morale, health and welfare activities must be available to all employees and not operated in discriminatory manner. Disparities in the availability of these activities may occur based on the employees status as a member of management, length of service, collective bargaining agreements or regular hours of employment. Disparities may not occur within classes of employees. The costs of the program must be equitably apportioned to all activities of the organization.

- Income generated from any of the fees charged or monetary collections taken for employee functions, such as dinner dances, must be used to defray the operating costs of the employee, morale, health, and welfare activities unless the income has been designated to be furnished to employee welfare organizations such as an employee benevolent society.

The costs associated with the employee morale, health and welfare, activities must be adequately supported through written documentation.

16. May organizational memberships, subscriptions, professional or board of director related costs In Commonwealth-funded programs ever be considered reimbursable state or federal costs?

Yes: The reimbursable and nonreimbursable cost provisions of DPS regulations and federal OMB Circular A-122 indicate that these costs may under certain circumstances be reimbursable. Reimbursable operating costs (808 CMR 1.02) must be reasonably incurred or expected to be incurred in the provision of program services purchased by the Commonwealth and not be excluded from reimbursement by 808 CMR 1.15. The concept of reasonableness as it relates to reimbursement is further explained in the DPS Summary Sheet "Reimbursable and Non-Reimbursable Operating Costs,"

document number DPS-A035-93, dated August 1993. Operating costs in federally supported programs (including administration costs allocated to the program for reimbursement) must meet the general tests of allowable costs by being reasonable and allocable as shown in Attachment A of OMB Circular A-122.

Costs that are generally considered administrative in nature, or related to the board of directors, and contribute to the overall benefit of the agency and the programs receiving financial assistance from the federal government and the Commonwealth such as the organization's membership in civic, business, technical, and professional organizations are allowable as noted below.

Such costs may be reimbursable if their monetary value is relatively low compared to the program-related benefits derived from the results of these activities. For example, these costs may be associated with meetings and conferences, including the cost of meals and fees, held to conduct the general administration of the organization. These costs could be composed of a relatively inexpensive purchase of food and beverage (example, salad and cold-cut buffet, piece and sandwiches) that would permit the board of directors to conduct critical provider business during dinner hours. In addition, the costs of attendance by employees and board members at meetings and conferences, sponsored by others when the primary purpose is the dissemination of technical information that benefits federal and Commonwealth-funded programs, including cost of meals, transportation, and other items incidental to such attendance are allowable as follows:

- The provider's administrative and board-related costs, including organizational memberships, subscriptions, and professional activity costs must be incorporated into the providers written policies and must have been expected and not have been disapproved by the purchasing agency or DPS (if the provider is a Chapter 71B Approved Private School). Prior notice of the expected activities must be furnished to the purchasing agency or DPS (if the provider is a Chapter 71B Approved Private School) through the program proposal review process, award or renewal of the contract, through the program price approval

process, or by separate notification prior to the expenses being incurred.

- The costs associated with administrative and board-related costs, including organizational memberships, subscriptions, and professional activity are not excessive or unreasonable as defined in 808 CMR 1.15 (1) or if federally supported, are considered allowable as shown in Attachment A and Attachment B (24) and (25) of OMB Circular A-122. See also 808 CMR 1.15 (23) prohibiting luxury items.

- Providers that utilize a purchase of service contract for contracting with the Commonwealth must include the costs associated with the administrative and board-related costs, including organizational memberships, subscriptions, and professional activity as Administrative Support or Direct Care costs in Attachment B.: Fiscal Conditions/Program Budget of the purchase-of-service contract.

- The costs associated with organizational memberships, subscriptions, and professional activity must be adequately supported through written documentation (See 808 CMR 1.15 (26)).

Additional questions are welcomed by DPS Questions may be forwarded to the Bureau of Audit at the following address:

Director, Bureau of Audit
Executive Office for Administration & Finance
Department of Procurement & General Services
Division Of Purchased Services
One Ashburton Place, Room 1017
Boston, Massachusetts 02108

The Director of the Bureau of Audit met with Massachusetts Society of CPAs Grantees and Not-For-Profit Accounting and Auditing Committee on October 17, 1995 and answered the committee's prepared questions concerning the UFR. The following questions and answers were provided in a subsequent mailing to interested parties in the month of November 1995.

MASS SOCEITY OF CPAs QUESTIONS

1. **What is the definition of a program? Are there any exceptions to the requirement that cost reimbursement contracts should not be combined with unit rate contracts? What reporting is DPS expecting when this occurs?**

   What is a Program?

   The definition of a program is contained in 808 CMR 2.02, which is established pursuant to Massachusetts General Laws, Chapter 29, Section 29B, and is defined as follows:

   The delivery of ore or more discrete services in an organized and coordinated fashion in order to achieve objectives comment to all program participants.

   Overall specifications for programs furnished to Commonwealth agencies are established in the request for proposal (RFP) published by the Commonwealth. The specifications for each program to be furnished are contained in the proposal for the program which has been negotiated with the primary purchaser and incorporated into the contract awarded to the provider.

   UFR program numbers are assigned to programs by the primary purchaser and provider for each program during contract/program negotiations, amendment or renewal.

   Secondary Commonwealth purchasers of the program must utilize the program specifications negotiated by the primary purchaser. Regulation 808 CMR 2.07 indicates that other purchasing agencies' negotiations for the purchase of a portion of the program is limited to additional terms and conditions which do not materially modify the statement of work, fiscal terms (cost reimbursement/unit rate basis of payment or budget for the program) or other terms and conditions agreed to by provider and primary purchaser (such amount and source of offsetting income used to reduce negotiated program costs). The fiscal terms and conditions of a program will be inappropriately modified and in conflict if a combination of negotiated unit rate and cost reimbursement contracts are utilized to fund a program.

Additional guidance concerning primary and secondary procurement coordination is available in Selected Sections of The Executive Office of Health and Human Services (EOHHS) Secretariat Guidelines For the Procurement of Social and Rehabilitative Services of the UFR Compliance Supplement.

Why is it that a program may not be reimbursed by both negotiated unit rate and cost reimbursement contracts?

Provisions governing when a reimbursement may be made using a cost reimbursement contract are noted in 808 CMR 1.06 (3). These provisions indicate

that purchasing agencies may purchase services on a cost reimbursement basis only if:

a) The contract is in the start-up year, or

b) the purchasing agency has reason to monitor the actual expenditures of the provider, or

c) special circumstances exist which make service delivery under the fee-for-service or accommodations purchase provisions impractical or undesirable.

Permission to utilize a cost reimbursement contract under the provisions of 808 CMR 1.06(3)(c) may be authorized by the Division of Purchased Services in accordance with Division's policy.

The ability to monitor a start-up program or actual expenditures of a programmatically sensitive program, unstable program, or a program susceptible to, abuse is inhibited when both cost reimbursement and negotiated unit rate methods of payment are utilized to reimburse the program.

The need to monitor these types of programs has historically caused the Commonwealth to require that only one cost reimbursement contract be executed for a program and that program is to be available exclusively to the primary purchasing agency.

There is no ability to determine, in the UFR, if overbilling occurred in a program reimbursed by a cost reimbursement contract if the program is also reimbursed using a negotiated unit rate contract(s).

How do purchasing agencies and providers inappropriately enter into program procurements that are reimbursed by both negotiated unit rate and cost reimbursement contracts?

A secondary purchaser of a program may not communicate with the primary purchaser or be aware of the existence of a primary purchaser of a program and may inadvertently use a different basis of reimbursement to procure a portion of the program.

The primary purchaser may inappropriately use a cost reimbursement basis of payment to reimburse a provider for a line item or portion of a line item that is used to purchase specialized services subject to unexpected and fluctuating price increases or for services that may not be needed for the full term of the contract.

Are there exceptions to the restrictions placed on the use of cost reimbursement contracts or other types of unit rates that may be used with a cost reimbursement contract to fund a program?

- The Division of Purchased Services (DPS) may grant a waiver of its regulations in limited situations when warranted.

- Third-party payments (Medicaid billable class rates) may be utilized as an offset in a cost reimbursement contract.
- Non-negotiated unit rates (class rate) established by the Rate Setting Commission for Medicaid reimbursable services may be used by a Commonwealth purchasing agency to reimburse a provider for one or more services (ex. Early Intervention 114.3 CMR 7.00) furnished by a program that is reimbursed with a cost reimbursement contract.
- The program and its contracts may be amended during the year and the method of reimbursement for the program also changes (negotiated unit rate contracts become one cost reimbursement contract or a cost reimbursement contract becomes one or more negotiated unit rate contracts).

What audit steps should the independent auditor employ in the audit of the UFR when it is determined that a program is reimbursed on a negotiated unit rate basis and a cost reimbursement basis?

The provisions of Massachusetts General Laws, Chapter 29, Section 29B, require the purchasing agency and the provider to adhere to DPS regulations. Current DPS regulations as noted above do not provide for the reimbursement of a provider program with a combination of cost reimbursement and negotiated unit rate contracts.

Failure to follow the General Laws of the Commonwealth or DPS regulations is a condition of noncompliance which should cause the independent auditor to write a material finding of noncompliance with laws and regulations and/or a finding of a material weakness in the internal control structure (internal controls for compliance with laws and regulations) of the provider. The element of cause in the provider's internal control and/or compliance finding should in most cases indicate that the internal control structure of Commonwealth purchasing agency permitted the noncompliance to occur.

What action will DPS and the principal purchasing agency take when a material finding of noncompliance and/or a material internal control finding has appropriately been written or inappropriately not been written by the independent auditor?

- The DPS audit resolution policy requires the principal purchasing agency and the provider to correct material findings through a written corrective action plan that is made part of an administrative audit compliance agreement signed by both parties. When there are indications that material findings were not written and they may have been warranted, DPS would be required to take the following action:

  DPS would conduct further audit work or request the Office of the State Auditor (OSA) to conduct such world to determine the extent of any noncompliance or internal control deficiency when material internal control and compliance findings are not written by the independent auditor in accordance with the

supplemental procedures (1994 "Yellow Book" paragraph 5.10) that are noted in the UFR Audit and Preparation Manual and the Auditor's Compliance Supplement and the OMB Circular A-133. Such material findings of noncompliance and internal control may be warranted because it is probable that overbilling would occur or not be detected if a cost reimbursement contract is used to reimburse a program that is also reimbursed with a negotiated unit rate contract. Such additional audit work by DPS or OSA may have audit results that could prevent the provider from being prequalified to contract with the Commonwealth or could result in the Commonwealth recouping any overpayment that occurred in a cost reimbursement contract or requiring the return of any inappropriately retained revenues furnished through the surplus revenue retention policy. Such actions taken by the Commonwealth would most likely have a direct and material effect on the financial statements of the provider.

2. **What is the basis for requiring a reconciliation on overhead in the final billing of a cost reimbursement contract? It seems to be a consistent claim of providers that purchasing agencies have never required this. If this reconciliation is necessary, as a practical matter, how can this be accomplished without closing the books and preparing the UFR before completing the final billing.**

   - Cost reimbursement contracting carries with it the need for a greater degree of oversight and monitoring by the purchasing agency and the provider in that cost reimbursement contracting is a payment arrangement under which the purchasing agency reimburses the provider for budgeted overhead actually incurred in rendering the services specified in the agreement up to a stated maximum obligation. Overhead (administrative support) in cost reimbursement contracts is billed to the Commonwealth and reimbursed on a budgeted basis until the twelfth month when a reconciliation is conducted to ensure that actual and reimbursable overhead costs for the term of the contract meet or exceed the amount billed to the Commonwealth. The amount of actual overhead costs billed to the Commonwealth must be less than the negotiated administrative support cap for the program (contract). Purchasing agencies have not required that providers furnish evidence or exhibit the existence of the reconciliation of overhead in the past because it has always been believed that actual overhead costs generally exceeded the negotiated administrative support cap in the cost reimbursement contracts. Recent audits conducted by OSA and UFR reviews conducted by DPS indicate that overhead costs in UFRs reviewed and audited have not typically exceeded the negotiated administrative support cap as generally believed and many of these costs have contained nonreimbursable costs or non-program costs.

   - Conducting a reconciliation in the twelfth month of a cost reimbursement contract is needed to ensure that actual and reimbursable overhead costs for the term of the contract meet or exceed the amount billed to the Commonwealth and

the actual overhead costs billed to the Commonwealth are less than the negotiated administrative support cap for the program (contract). While the amount of overhead costs that need to be determined should not be materially different from the amount of overhead costs to be disclosed in financial statements or schedules of the UFR this accounting procedure requires far less accuracy, labor and time than would be needed for actual disclosure in the UFR.

- The reconciliation of overhead costs to ensure that overbilling does not occur in cost reimbursement contracts or unit rate contracts (actual incurred overhead costs are less than negotiated administrative support cap and amount billed on budgeted basis) billings to the Commonwealth should be attainable if the provider's accounting system can identify and segregate nonreimbursable items in overhead (as required by the General Conditions of the Master Agreement, 808 CMR 1.00 and OMB Circular A-110) and can estimate within reason overhead costs attributable to the purchased program.

3. **It was stated in the UFR training that a cost reimbursement contract should not show a surplus or a deficit. Since cost reimbursement contracts do not allow billing for accrued vacation (which is a GAAP requirement), how should the surpluses/deficits resulting from accrual differences be handled on the UFR?**

   - The Commonwealth reimburses providers for employee services rendered and accrued vacation time (example 50 weeks of employee services and 2 weeks of accrued vacation) in cost reimbursement contracts as specified in program proposal (that becomes part of the contract) for the term of the contract year (generally 52-week year). The Commonwealth does not pay for employee services and vacation time in excess of the amounts defined in the proposal which is generally a 52-week period (these costs are considered nonreimbursable).

   - Typically, these nonreimbursable costs are incurred when employees do not take vacations (vacation time is accrued and reimbursable under contract when this occurs) and they provide employee services in excess of the amount specified in the proposal (example: employees furnish employee services for 52 weeks rather than 50 weeks as specified in proposal and accrues 2 weeks of vacation tone). In the aforementioned example, the 2 weeks of accrued vacation time are considered reimbursable but the employee services furnished in excess of 50 weeks are considered nonreimbursable because this payroll expense was not included in the negotiated contract budget or the proposal.

   - Providers are encouraged to employ adequate internal controls and to use good business practice by utilizing policies that require employees to take vacations and/or loose vacation time if not taken within a specified period of time. Providers are also encouraged to adequately budget for staff coverage or use relief staff in a manner that permits employees to take vacation without loss in

program performance. These measures, if adequately employed, would prevent or limit nonreimbursable costs attributable to excess employee services.

4. **What is the understanding or expectation of DPS as to the level of work that a CPA should perform on the unaudited schedules of the UFR when they are prepared by the provider?**

   The DPS bureau of audit expects that the independent auditor should furnish the level of world to the unaudited schedules of the UFR as required by the appropriate AICPA statements on auditing standards. These standards require the auditor to report on all the information in the document by using a supplements information paragraph in the auditor's report on the financial statements or a separate report. The standards also require the independent auditor to read the supplemental information and consider whether

   - the supplemental information, or the manner of its presentation is materially inconsistent with the information, or manner of its presentation, appearing in the basic financial statements.

   It is DPS's understanding that this would require the auditor to consider whether the supplemental information and the information in the basic financial statements is materially inconsistent as follows:

   1) Different functional and natural classification is inappropriately used in the supplemental schedules and basic financial statements.

   2) Fund, account, cost category and program totals of supplemental schedules do not reconcile with basic financial statements totals as required.

   3) The amounts and classification of revenues, expenses and fund balances disclosed in supplemental schedules are materially inconsistent with the information or manner of its presentation in the basic financial statements.

   4) Nonreimbursable costs disclosed in supplemental schedules are materially inconsistent with the independent auditor's audit results of testing and reporting on internal controls and for compliance with laws and regulations in a financial statement audit. In addition, nonreimbursable costs disclosed in supplemental schedules are materially inconsistent with the independent auditor's audit Exults of performing further supplemental procedures of testing and reporting on internal controls and compliance with laws and regulations in accordance with the requirements of OMB Circular A-133 and the UFR Audit and Preparation Manual and Auditor's Compliance Supplement.

   If the information is materially misstated DPS, would expect and the SASs oblige the auditor to accomplish the following:

   - Discuss matter with the provider and propose revision;

- if the client refuses to revise the supplemental information, the auditor should modify the report on the financial statements or reports on internal controls and compliance;
- describe the misstatement, to include the information or the use of auditor's reports, or withdraw from the engagement.

5. **What flexibility exists when disclosing revenue retention amounts? Can the disclosure be included as supplemental information rather than included In the footnotes to audited statements?**

   Financial activity attributable to Commonwealth purchase of service (POS) contracting generally represents most of a provider's financial activity (approximately 70% of all revenues and expenses accrued by providers are related to POS contracting) and a substantial amount of other financial activity would not occur without POS contracting (third-party revenue, client resources, POS sponsored client fees, etc.). Disclosure of revenue retention amounts including liabilities and revenues to be retained should be made in the financial statements and notes to the financial statements. These disclosures should occur in that the liabilities and contingencies associated revenues to be retained as determined by the revenue retention estimates made by the provider could directly impact the classification and bases of amounts set forth by a provider in the financial statements and the ability of the provider to fulfill its regulatory and contracting obligations. Statement of Financial Accounting Standards No. 5 (FASB No. 5) provides guidance regarding appropriate accounting and disclosure requirements for gain and loss contingencies associated with the retained revenue retention amounts. In that the disclosure of revenue retention amounts are Squired through regulation and contract terms and conditions and such disclosures are subject to FASB No. 5, disclosure could in most cases only be made in the financial statements or as footnotes to the financial statements. Disclosure of the amounts could be included as supplemental information rather than included in the financial statements or the footnotes to audited statements if the amount of POS contracting that the provider participates in and the contingencies involved are not material to the Commonwealth and the provider's financial statements. A request to DPS for prior approval to disclose revenue retention amounts as supplemental information in the UFR should be made if the provider believes that the amount of POS contracting that the provider participates in and the contingencies involved are not material to the Commonwealth and provider's financial statements.

6. **It appears that when the DPS staff encounter "deficiencies" in a UFR that correspondence is immediately sent to the provider, the CPA & the purchasing agent regardless of the significance of the "deficiencies". When DHHS reviews audits, many issues are resolved over the telephone before any correspondence is generated. Is it possible to establish a level of reasonableness in the review process to determine when issues could be resolved over the telephone before sending unnecessary correspondence? Our committee would be happy to work**

with DPS staff in establishing parameters for determining minor vs. major issues.

The conclusions section of the DPS Bureau of Audit Desk Review Guide contemplates that minimum filing deficiencies (as listed in UFR Preparation and Audit Check List) should be communicated by telephone to the provider and/or independent auditor whenever possible and appropriate. The bureau previously furnished information regarding notification of UFR deficiencies by telephone in question number 14 of its document entitled Questions And Answers On Audit and Preparation Of The UFR, issued August 1994. The answer to question number 14 in this document noted the following: "The Bureau of Audit attempts to notify providers and independent auditor about deficiency items requiring limited explanation over the telephone. Staff of the Bureau of Audit spend a substantial portion of their workday providing guidance on the telephone to providers and independent auditors concerning issues related to the filing requirements of the UFR" As a general rule, items requiring limited explanation are defined as having approximately one to three minimum filing deficiencies. In addition, telephone notifications are used when providers and independent auditors are being notified of deficiencies when the notification does not need to be documented in writing. Filing deficiencies may need to be documented in writing to provide due process when numerous minimum filing deficiencies exist; when prior year deficiencies are -repeated in the current UFR filing; when deficiencies are not corrected after repeated written notifications and when the possibility and/or probability exists that sanctions and penalties will be imposed. Currently, a substantial number of UFR filings are determined to be deficient and the vast majority of deficiency letters contain more than three minimum filing deficiencies as well as other audit and preparation filing deficiencies. The Bureau of Audit would be happy to receive suggestions or discuss with the committee the possibility of deleting or adding items listed as minimum filing deficiencies in the UFR Preparation and Audit Check List, if appropriate.

7. **Is there anything that can be done in order to issue federal funding letters earlier?**

Timing for the release of federal funding letters is predicated upon when the Commonwealth's accounts payable is closed out and providers' reimbursements are no longer being honored for the fiscal year. In recent years, the Commonwealth's accounts payable has closed out on the last day of August. In the current year, federal funding information could not be retrieved on a timely basis from the Commonwealth's accounting system because of computerization problems.

The Bureau of Audit has furnished federal funding letters to providers as a courtesy and in order to provide one additional measure of comfort to providers and auditors. These letters have always been careful to point out that the letters are not official documents of the Commonwealth and they are not being furnished for confirmation purposes. Unfortunately, providers and auditors have come to rely on

these letters and to use them as the primary method of notification for federal funds furnished.

The primary method that the Commonwealth uses to inform providers of the type and level of federal funds furnished is through listing of the CFDA number on the cover page of each contact with an accompanying federal award letter if the contract is not totally federally funded. The accompanying federal award letter notes the proportion of federal and state funding to be furnished. The vast majority of contracts are not accompanied with a federal award letter because the POS contract is totally federally funded.

There is one exception to notification practice which involves some federal funds furnished through POS contracts by the Department of Social Services (DSS) to providers being reimbursed through certain appropriation accounts. The cover page of these POS contracts do not include the CFDA number in that the Commonwealth uses its funds first then allocates the amount of federal assistance to be received from the federal government using a formula (which is less than the amount of Commonwealth funds first used) to all providers in certain Commonwealth appropriation accounts. This procedure prevents the Commonwealth from determining before the contract is executed the amount, if any, of federal financial assistance to be furnished to each provider through these appropriation accounts.

In the event that the Commonwealth does not furnish information concerning federal financial assistance, the provider and independent auditor should follow the guidance furnished in questions numbered 40, 54, and 55 in Questions and Answers on OMB Circular A-133, published by the President's Council on Integrity & Efficiency (enclosed).

The Bureau of Audit is currently considering the possibility of not furnishing federal funding letters in the future in that these letters furnished by DPS duplicate the notification made through the contract cover page, and when necessary, the accompanying federal award letters. The elimination of this notification process would free up bureau of audit staff to work on more pressing issues. The bureau would continue to furnish letters to the to providers contracting with DSS that have federally funded contracts being reimbursed through certain appropriation accounts for which the contract cover page does not include a CFDA number and when necessary, the accompanying federal awards letter. Each Commonwealth purchasing agency would be responsible for notifying providers directly through contract amendments or by other means of any additional federal funds furnished or changes in the amount or type of federal assistance furnished during the year.

8. **What is the DPS policy regarding making CPA firm referrals or recommendations?**

The DPS bureau of audit does not make any referrals of CPA firms to other state agencies or providers or recommendations concerning audit services. The Bureau of Audit conducts its affairs in accordance with generally accepted government auditing standards (GAGAS), such referrals or recommendations would constitute a

departure from the second general standard of GAGAS concerning independence. Staff of the Bureau of Audit are required to sign an independence certification form for each UFR reviewed to ensure that departures from the second general standard of GAGAS do not occur. The Bureau of Audit has on occasion furnished to individuals a listing of all CPA firms auditing the UFR or has referred these individuals to the Massachusetts Society of CPAs for information concerning audit services. The Bureau of Audit has infrequently purchased training services from CPA films or has been furnished training services free of charge from CPA firms in the past. On occasion, the Bureau of Audit has furnished references limited solely to the training services that were furnished.

What is the overall objective of DPS in the UFR review process and how can our committee work with your staff in facilitating the process?

The UFR review process provides a level of assurance regarding the usefulness of the UFR. The review process ensures that the Auditor's Reports, financial statements, schedules and other supplemental information filed in the UFR meet applicable accounting principles and auditing standards in accordance with the regulations and instructions promulgated by DPS. The use of the DPS desk review guide in meeting these objectives is to ensure that the Division's legislative mandate in accordance with Chapter 110, section 274 of the Acts of 1993 to develop and administer a uniform system of financial accounting, reporting, allocation, and auditing of providers which conforms to generally accepted government auditing standards is accomplished. The review process enables report users composed of contributors, federated fund-raising organizations, other donor groups, organizations affiliated with the provider, contributor information bodies, governmental regulators, beneficiaries, lenders, bonding institutions, suppliers, federal, state and municipal grant and contract awarding agencies, legislators and concerned citizens to use the report for its intended purposes as follows:

- Testing and reporting on a provider's internal controls and compliance with laws and, regulations contribute to the evidence supporting the auditor's opinion on the financial statements and provides limited assurance to UFR report users concerning the auditor's understanding of the entity's internal control structure and compliance with laws and regulations material to the financial statements. Preparation of a corrective action plan by the provider and the execution of an administrative audit compliance agreement with the Commonwealth provides a measure of assurance to report users that findings reported in the auditor's reports on internal controls and compliance will be corrected. Audit follow-up by independent auditors on known material findings and recommendations from previous audits provides an additional level of assurance to UFR report users that findings will be corrected.
- The supplemental procedures of testing and reporting on a provider's internal controls and compliance with laws and regulations as prescribed in the UFR Audit and Preparation Manual and Auditor's Compliance Supplement and OMB

Circular A-133 provides limited assurance to UFR report users concerning the auditor's understanding of the entity's internal control structure and compliance with laws and regulations material to Commonwealth and federal programs. Preparation of a corrective action plan by the provider and the execution of an administrative audit compliance agreement with the Commonwealth provides a measure of assurance to UFR report users that findings reported in the auditor's reports on internal controls and compliance will be corrected. Audit follow-up by independent auditors on known material findings and recommendations from previous audits provides an additional level of assurance to the UFR report users that findings will be corrected.

- When nonreportable items are included in the provider's management letter, a measure of assurance is furnished to UFR report users that management will be able, through this notification, to maximize the efficiency of its internal controls and compliance with-laws and regulations.
- The information disclosed in the basic financial statements and unaudited schedules provides UFR report users with a wealth of reliable information to make rational decisions about financing, endowing or subsidizing of the provider. The information provided concerns the results of the providers operations for the agency and its programs. The UFR report users have the opportunity to use this information to learn about the provider's economic resources, obligations, and net resources and for determining how the organization spends cash or other liquid assets. The information also informs the UFR report users about the effects of transactions, events and circumstances that change resources and interests in those resources. In addition, information about borrowing and repayment of borrowing, along with other factors that may affect the provider's liquidity, is also furnished to UFR report users.
- The information furnished in the unaudited Supplemental Schedule D, Service Efforts and Accomplishments, provides the UFR report users with information that will assist in assessing the performance of the provider. This information assesses what the UFR report users are getting for the use of public funds and how economically, efficiently and effectively these funds are being used. The UFR Auditor's Compliance Supplement indicates that the auditor should test the provider's internal controls and compliance with contract performance and service documentation requirements. The results of this testing provides a measure of assurance to UFR report users regarding the ability of the provider's collection, tracking and reporting of services furnished through the disclosure of indicators of economy, efficiency and effectiveness of the program's outputs and outcomes (accomplishments) reported in this schedule.
- The information reported in the unaudited Rate Setting Commission schedules is used to establish Medicaid reimbursable class rates of payment and to provide UFR report users with a level of comfort concerning the rates established using this cost information.

The UFR is a document which is very useful to UFR report users because it is a audited uniform document which permits the UFR report user to compare one provider to another, or similar types of providers or one segment of the industry to another segment of the industry.

The information in the UFR data base is made available to agencies and other UFR report users for generating management reports and for establishing funding priorities. This would not be possible if the UFR was not a audited uniform document and if the DPS Bureau of Audit did not provide a level of assurance concerning the accuracy and adequacy of the UFR through its reviews. The UFR is also used by other Commonwealth management to conduct contract prequalification reviews to assess provider's financial viability and its compliance with laws and regulations prior to executing contracts. In addition, the UFR review process is also used as an indicator for determining if further audit work needs to be conducted by DPS or the OSA to establish the full extent of inadequate internal controls, irregularities, illegal acts, and other noncompliance.

Providers need to become more proficient and take more responsibility for the maintenance of adequate accounting systems and the preparation of financial statements in accordance with generally accepted accounting principles. The fourth general standard of GAGAS requires that the independent auditor have an appropriate internal quality control system to ensure that the organization has adopted, and is following applicable auditing standards and has established and is following, adequate policies and procedures. When establishing such a system the independent auditor needs to ensure that the UFR report users needs are met by adopting policies and procedures that prevent UFR minimum filing deficiencies from occurring.

The Committee can help facilitate the review process in the immediate future by impressing upon practitioners and their clients through news letters, training or follow-up procedures of the need to ensure that the UFRs are adequately prepared and audited (includes reading and considering supplemental information) as is needed. There is also a need to impress upon the practitioner the need to improve the quality of audit findings that are written in UFRs by ensuring that they contain the required "Yellow Book" elements of a finding which result in clear, concise and convincing findings. Adequate audit findings will enable purchasing agency and provider staff to adequately correct deficiencies and improve the delivery of services to clients of the Commonwealth.

DPS-A035-97 (REVISION 3)
(Supersedes version dated August 1995)
August 1997

DIVISION OF PURCHASED SERVICES
SUMMARY SHEET

SELECTED REIMBURSABLE AND NON-REIMBURSABLE OPERATING COSTS

NOTE: This summary sheet has been updated to reflect amendments to regulation 808 CMR 1.00 as of February 1, 1997 and supersedes the version dated August 1995 where inconsistencies exist.

INTRODUCTION

Funds received from a Commonwealth Department for the provision of a social service program may only be used by a Contractor agency for costs which are "reimbursable operating costs" as defined in Division of Purchased Services regulation 808 CMR 1.02. This rule applies to the expenditure of funds received by programs purchased pursuant to a purchase-of-service contract and pursuant to the Commonwealth's special education law, M.G.L. c.71B.

In addition, certain costs have been specifically identified as non-reimbursable in regulation 808 CMR 1.05 so that in no circumstance may Commonwealth funds be budgeted or used for these costs. Even funds from Commonwealth sources that are allocated to defray agency administration expenses or funds properly accumulated pursuant to the surplus revenue retention provisions of regulation 808 CMR 1.03(7) cannot be used for non-reimbursable items. Funds received in payment for an approved special education program, where the price used for payment purposes is the Commonwealth developed price, regardless of source of payment, also cannot not be used for non-reimbursable items. Expenses in a Commonwealth purchased program that are not reimbursable must be offset with other Contractor funds; public dollars which are used for non-reimbursable expenses are subject to recovery through a variety of mechanisms.

In this summary sheet, we attempt to assist Departments and Contractors in making the determinations necessary for deciding what are reimbursable operating costs under 808 CMR 1.02 and 808 CMR 1.05 in Commonwealth purchased programs.

Regulatory Reference:

Division of Purchased Services regulation 808 CMR 1.00, (effective 2/1/97). in particular sections 808 CMR 1.02 (definition of "reimbursable operating costs") and 808 CMR 1.05 (listing of specific non-reimbursable costs)

Other Informational Material:

Office of Management and Budget Circular No. A-122, "Cost Principles for Nonprofit Organizations," (recompilation May 14, 1997).

REIMBURSABLE OPERATING COSTS

808 CMR 1.05 states as follows:

> *Funds received from Departments may only be used for Reimbursable Operating Costs as defined in 808 CMR 1.02. In addition, funds may not be used for costs specifically identified in 808 CMR 1.05 as non-reimbursable. Expenditures not in accordance with this paragraph are subject to recoupment, intercept, offset and where appropriate, the Authorized Price is subject to adjustment, as determined by the Commonwealth.*

808 CMR 1.02 defines reimbursable operating costs as follows:

> *Those costs reasonably incurred in providing the services described in the contract and/or, in the case of a Program approved under the provisions of M.G.L. c. 71B, in providing the services mandated by DOE or specifically included in an Authorized Price, with the exception of costs enumerated in 808 CMR 1.05 and costs excluded in the Authorized Price. Operating costs shall be considered "reasonably incurred" only if they are reasonable and allocable using the standards contained in Federal Office of Management and Budget Circular A-122or A-21, or successors thereto.*

The OMB Circular No. A-122 standards for reasonable are as follows:

> *3. Reasonable costs. A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. .... In determining the reasonableness of a given cost, consideration shall be given to:*
>
> *a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award [*in this case, the performance of the contract or the delivery of program services*].*
>
> *b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.*
>
> *c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Government.*
>
> *d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.*

OMB Circular No. A-122 describes allocable costs as follows:

> *4. Allocable costs.*
>
> *a. A cost is allocable to a particular cost objective, such as a grant, project, service or other activity, in accordance with the relative benefits received. A cost is allocable to a Government award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:*

(1) Is incurred specifically for the award.

(2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received.

(3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

b. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

Thus, in determining reimbursability, one must assess whether the cost is incurred for the program, is reasonable both in its nature and its amount, and is properly allocable.

Costs Incurred in Providing the Contracted or Mandated Services. The first step then in assessing whether a cost is reimbursable involves determining whether a cost would be "reasonably incurred in providing the services described in the contract" or, in the case of a special education program, "in providing the services mandated by DOE or included in an Authorized Price." This requires an examination of the agreement between the Contractor and Department to determine whether the Department anticipated paying for the cost because it was contained or described in the program budget or because the cost is necessary for the Contractor to deliver the program of services mandated by the Department of Education. The question for the Contractor then is not whether the cost satisfies some element of its agency's mission, but whether the cost is, to use OMB Circular A-122's terms, "ordinary and necessary" for the provision of the particular services that the Department has agreed to buy. In essence, the question to be answered is: Is the expenditure within the scope of the agreement?

Reasonable in Nature. OMB Circular A-122(3) requires that to be reimbursable, an expense must be reasonable in nature and be of the kind that "would be incurred by a prudent person under the circumstances." In making this determination, Circular A-122 suggests the expense be compared to the "type generally recognized as ordinary and necessary for the operation of the organization or performance of the award." Note that an expense is not reimbursable simply because it satisfies some element of its organization's mission. The cost must be "ordinary and necessary" for the provision of the particular services the Department has agreed to buy. Experience suggests that if the program budget is developed directly from the proposal or contract's description of services, then most of the resulting budget items will be ordinary and necessary for the program.

Reasonable in Amount. In order to be reimbursable, the expense must also be reasonable in amount. In considering the amount of an expenditure, Circular A-122 suggest that we consider whether the amount "exceeds that which would be incurred by a prudent person." Prudence is supported by the use of good business practices or demonstration of arms length bargaining. Webster's dictionary provides further guidance on what is reasonable by the use of the term "moderate". By contrast, unreasonable costs are defined in 808 CMR 1.05(1) as "any amount paid for goods or services which are greater than either market price or the amount paid by comparable Departments..."

Allocable. In addition to the above consideration to be reimbursable, expenses must also be properly allocable to Commonwealth programs. Generally, if an expense is contained in the program budget, contract description of services or is necessary for the delivery of the mandated program of services, then the resulting expense will likely be considered reimbursable. For a detailed discussion of general cost allocation principles governing Commonwealth contracts, please see OMB Circular A-122, 808 CMR 1.05(26), the audit and recordkeeping provisions associated with the Uniform Financial Statements and Independent Auditor's Report (UFR) and generally accepted accounting principles ("GAAP").

When it is still unclear if a cost is reimbursable, then the Contractor should seek the advice of its Department prior to the expenditure of funds for the questionable purpose. Early communication may prevent future misunderstandings, as well as may eliminate audit issues. Generally, it is prudent to assume a questionable cost is non-reimbursable, unless otherwise confirmed.

NON-REIMBURSABLE COSTS

In addition to costs that are not reimbursable because they are not ordinary and necessary for the delivery of what the Commonwealth is buying, there are costs which have been specifically identified as non-reimbursable because of Commonwealth and Federal legal restrictions. These special "non-reimbursable costs" are delineated in Division of Purchased Services regulation 808 CMR 1.05.

A determination must first be made that an expense is potentially reimbursable under 808 CMR 1.02 (see discussion above) before considering the additional restrictions imposed under 808 CMR 1.05. 808 CMR 1.05 further emphasizes that in paying for a social service program the Commonwealth should only pay for program related, reasonable and documented expenditures. See in particular, 808 CMR 1.05(1), (12), and (26).

While all of the provisions of 808 CMR 1.05 should be reviewed, a number of them are highlighted below and certain sections of those provisions are further clarified:

(1) Unreasonable Costs. Any costs not determined to be Reimbursable Operating Costs as defined in 808 CMR 1.02 or any amount paid for goods or services which is greater than either the market price or the amount paid by comparable Departments or other governmental units within or outside of the Commonwealth.

This provision specifically says that costs which do not meet the criteria for reimbursable operating costs would be considered unreasonable and therefore non-reimbursable. In addition, costs which are above market price are unreasonable. Market price can be determined using appropriate sources of information. For instance, the market price and the price paid by other organizations for general transportation vehicles would be established by using the manufacturer's fleet price for general transportation vehicles or by consulting publications on vehicle costs issued by insurance companies. In addition, 808 CMR 1.05(23) provides that luxury items are not reimbursable in Commonwealth programs.

(5) Certain Salaries and Consultant Compensation. Those salaries, wages, and consultant compensation considered to be excessive by DPS, in light of salaries, wages and consultant compensation of other comparable Contractors.

In developing a program budget, in most instances the amount for program salaries, wages, and consultant compensation should not exceed the market price ranges for these positions or components. Again, salaries, wages and consultant compensation must be program related under 808 CMR 1.02 and 808 CMR 1.05(12) before further consideration. See also 808 CMR 1.05(21)(non-reimbursable litigation costs) and 808 CMR 1.05(24)(non-reimbursable salaries of officers and mangers).

(6) Bad Debts. Those amounts (whether estimated or actual) which represent the portion of an account or note receivable that proves to be entirely uncollectible despite collection efforts including legal action, and any related legal cost.

This provision is not intended to limit valid program debt collection efforts through the use of legal representatives, but is intended to discourage the frivolous pursuit of claims. The notion is that when a debt is ultimately uncollectible then its validity is questionable and therefore the expenses associated with the attempted collection should not be considered reimbursable by the Commonwealth. Expenses associated with the successful collection of valid/legally enforceable debts for programs being purchased by the Commonwealth are reimbursable. However, when all legal avenues of collection have not been exhausted, then any expenses incurred in the unsuccessful pursuit of such disputed debt are not reimbursable. In addition, should a court of law determine that a claim is not valid, then the expenses incurred in pursuing the claimed debt are also not reimbursable. Also, the amount of any debt attributable to others (i.e., owed by non-Commonwealth entities) is never reimbursable by the Commonwealth.

(8) Related Party Transaction Costs. Costs which are associated with a Related Party transaction are reimbursable only to the extent that the costs do not exceed the lower of either the market price or the Related Party's actual costs. Notwithstanding the above provision, when the following conditions are satisfied Related Party transaction costs are reimbursable up to market price:

a) the transaction is for a good or service which the Related Party sells to the general public;

b) the Related Party's transactions with the Contractor in the reporting year comprise less than 10% of the Related Party's annual sales of that good or service to the general public (excluding sales to other parties also related to the Related Party under FASB 57); and

c) the Contractor has approved the transaction by a vote of independent directors, or a committee of independent directors, following full disclosure of the Related Party's interests.

Further, costs associated with a Related Party transaction which would not be Reimbursable Operating Costs to a Contractor under 808 CMR 1.02 and

808 CMR 1.05 are non-reimbursable. Transactions with a related party totaling less than $100 annually may be reimbursed at market prices.

This regulatory language was revised by DPS in 1997 to allow greater flexibility for organizations to accept services or goods from a Board member or other Related Party, generally at some discounted price but not necessarily "at cost". However, the general rule continues to be that the reimbursable costs of related party transactions shall be limited to the actual cost of a particular good, service, or facility when incurred by the related party, or market price - whichever is lower. This general rule is modified by a provision that specifies that actual related party costs are reimbursable only to the extent that they would have been allowable under the reimbursable operating costs provision of 808 CMR 1.02 and the non-reimbursable cost provisions of 808 CMR 1.05 if the Contractor itself had incurred the costs.

When a market price is difficult to establish, the allowable reimbursement level for a related party transaction should be the actual cost of the item in question, adjusted to reflect those other limitations on reimbursement which would apply to the primary Contractor (as set forth elsewhere in 808 CMR 1.05 or in applicable Federal guidelines). For purposes of reimbursing for real estate, these allowable costs to the primary Contractor are typically construed to include depreciation (as limited by the provisions of 808 CMR 1.05 (2)), interest (as limited by 808 CMR 1.05 (3)), and allowances for routine operating expenses, repairs and maintenance of the property in question.

Please note also that 808 CMR 1.04(4) requires that Contractors provide prior notice of a related party condition or transaction. This can occur through some of the already existing disclosure opportunities, such as in responses to a Request for Responses (RFR), on the organizational chart submitted for annual contract prequalification, or during contract and/or amendment negotiations. Failure to comply with the notice requirements may result in the imposition of penalties. See 808 CMR 1.04(11).

(9) Certain Fringe Benefits.
(a) Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable Contractors and fringe benefits to the extent they are not available to all employees under an established policy of the Contractor. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs.
(b) Employer contributions to pension, annuity and retirement plans which have been denied approval by the Internal Revenue Service.

To be reimbursable, fringe benefits must be available to all employees under an established written policy (in accordance with GAAP) of the Contractor and must not be excessive in comparison to salary and benefit levels of other similar Contractors. The policy may include provisions that permit the availability of different levels and types of fringe benefits for employees based upon the employee's length of service, collective bargaining agreements or regular hours of employment. However, please note that fringe benefits available only to

management, such a special pension benefit or reimbursement for college course work, are not reimbursable expenses to state contracts.

Bonuses are not considered a fringe benefit; rather, they are properly classified as a salary allowance when attributable to services rendered by an employee. Bonuses are a negotiable item, which are added to salaries in the budget and in the financial statements. The net salary amounts must not exceed what is considered reasonable compensation to be reimbursable. There are two ways to furnish bonuses to employees: one is a fixed bonus as part of an employee's salary based on terms incorporated into his or her written employment agreement, and the second is through a Contractor's written employee morale, health and welfare policy, which makes available bonuses to all employees based on exceptional employee performance. See section 162 of the Internal Revenue Code and 808 CMR 1.05(20) for further guidance.

A Contractor's employee, morale, health and welfare policy is also frequently confused with and inappropriately budgeted and/or reported as fringe benefits. Costs associated with the Contractor's employee, morale, health and welfare policy are not budgeted and/or reported on the UFR separately, as fringe benefits, but rather under Administrative Support, Direct Care or Occupancy costs, as applicable. However, unlike fringe benefits, the Contractor's employee, morale, health and welfare policy may exclude members of management from benefiting or participating in the employee, morale, health and welfare activities of the Contractor. Bonuses that are provided to management in addition to a fixed bonus awarded pursuant to the terms of an employment agreement and not as part of a Board approved employee morale, health and welfare plan are not reimbursable. Further information concerning the reimbursement of employee, morale, health and welfare activities is available in the DPS publication "Additional Questions and Answers on Audit and Preparation of the UFR for Contractors and Their Independent Auditors" issued May 1995, and in OMB Circular A-122.

(10) <u>Fundraising Expense.</u> The cost of activities which have as their primary purpose the raising of capital or obtaining contributions, including the costs associated with financial campaigns, endowment drive and solicitations of gifts and bequests. However, if a Program does not, or cannot reasonably be expected to, receive federal funds, the raising of capital or obtaining contributions for Commonwealth programs may be off-set against the revenue generated, except no loss will be reimbursable. To be reimbursable, the Contractor must maintain accounting systems which adequately segregate those fundraising expenses and revenues associated with Commonwealth purchased programs from other Contractor programs in accordance with generally accepted accounting principles.

Commonwealth program revenues may be used to defray fundraising costs in those Commonwealth purchased programs which do not receive federal assistance <u>only</u> if the fundraising activity generates revenues in excess of the expenses incurred for the fundraising effort.

(12) Non-Program Expenses. Expenses of the Contractor which are not directly related to the social service program purposes of the Contractor.

Please see the discussion on reimbursable operating costs (beginning on page 2).

(13) Security Deposits. Money deposited by the Contractor with a lessor of real property as security for full and faithful performance of the terms of a Contractor's lease.

The Commonwealth does not reimburse for security deposits based on the assumption that security deposits will be returned to the Contractor upon faithful performance of the terms of the Contractor's lease.

(14) Free Care. Costs associated with free service and use.

Since a contract executed with a Department should fully and adequately describe the purchased program and the clients to be served, it would be inappropriate for Commonwealth resources to be used for services and/or clients not included in the contract. To the extent that Commonwealth dollars are used for "free care", the cost of the program to the Commonwealth could be inflated or the Commonwealth would be forced to pay for costs or services for which there has not been a legislative appropriation.

(16) Management Agency Fees. Fees charged to the Contractor by a management agency which exceed the costs the Contractor would have incurred had it not entered into a management agreement.

Management agency fees must be allocated to the agency administration and support component. As such, the limitations on agency administration based on 808 CMR 1.05(1) [unreasonable costs] apply to this circumstance and any portion of a management agency fee that brings agency administration costs above the allowable cap established in the contract is non-reimbursable. See the discussion on pages 4-5 for details.

(19) Certain Reporting Year Expenditures. Reporting year expenditures in the operating fund for which restricted funds were available but not used.

Consistent with generally accepted accounting principles and this provision, organizations are required to use restricted funds for their intended purpose (such as donations received to acquire program equipment) and must exhaust such funds before seeking any reimbursement from the Commonwealth for those program expenses.

(21) Litigation Costs. All costs incurred in connection with the prosecution or defense of claims against the State or any of its subdivisions, including, but not limited to, legal, accounting and consulting costs. Reasonable expenses of a successful administrative price appeal under 808 CMR 1.06(6) will not be considered non-reimbursable.

Reimbursement may not be provided for costs associated with legal disputes involving the Commonwealth or its subdivisions (including cities and towns), with the exception that reasonable expenses associated with successful administrative appeals of pricing decisions may be reimbursable.

(22) Unallowable Costs under OMB Circular A-122 and A-21 or Successor Provisions. Costs which are not allowable under OMB Circular A-122 and A-21, or successor provisions, are non-reimbursable to Programs which receive federal financial assistance.

These federal circulars identify the allowable and non-allowable portion of costs for over fifty types of costs. Copies of OMB Circulars A-122 and A-21 may be obtained on the Internet at http://www.whitehouse.gov/wh/eop/omb. The UFR Auditor's Compliance Supplement also contains copies of these documents.

(23) Luxury Items. All costs associated with luxury items, including, but not limited to luxury passenger automobiles as defined in sections 4001 or 4002 of the Internal Revenue Service Code, airplanes, boats, vacation homes, alcoholic beverages, charitable contributions and donations, and all non-program entertainment expenses.

State contracts may not be charged for luxury items even when the items are used in support of state funded program. For example, where a luxury automobile that is owned by the Contractor is used to provide client transportation, no portion of the vehicle or associated operating expense may be charged to state contracts. Furthermore, where luxury items are used in support of state programs, the Contractor must document and identify in the UFR the source of funds used to defray the luxury expenses.

(24) Salaries of Officers and Managers. Salaries of officers and managers to the extent they exceed the rate paid to state managers in job group M-XII, step seven.

See the Division of Purchased Services' Policy Guidance relative to reimbursement for officers and managers salaries which is contained in the UFR Compliance Supplement. See also the discussion above relative to 808 CMR 1.05(1)(unreasonable costs) and 808 CMR 1.05(5)(certain salaries and consultant compensation).

(25) Mortgage Principal. Mortgage principal on an amortized or other basis: no Department shall reimburse a Contractor for the principal portion of any note secured by a mortgage on property owned directly or indirectly by the Contractor.

Under the provisions of St. 1993, c.495, s.99, and consistent with prior practice, mortgage principal may not be charged to state contracts.

(26) Undocumented Expenses. Costs which are not adequately documented in light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.

Contractors are required to maintain documentation of expense in accordance with contract requirements and GAAP provisions. When questions are raised about

expense, the Contractor is obligated to provide documentation supporting the nature and amount of the expense. Where sufficient documentation is not produced or available, the Commonwealth funds used to defray the expense may be recouped by the State.

(27) Administration and Support Costs. Costs which are otherwise non-reimbursable under the provisions of 808 CMR 1.05 may not be reimbursed through Administration and Support Costs.

Where expenses are specifically excluded from reimbursement under 808 CMR 1.05, they can be charged to the state as part of agency administration. For example, if the Contractor owns and operates a luxury vehicle, any costs related to its use may not be charged to state contracts directly nor could the expense be lumped into agency administration and charged to a state contract through the allocation process.

SUMMARY: Checks for Avoiding Non-reimbursability Issues

1. Build the budget from the service description (in the RFR and/or contract program description or in the Department of Education program approval documents).
2. Review the expenses to confirm they are specified in the contract or price approval.
3. Review any correspondence or price approval documents specific to your agency which describe or otherwise limit reimbursable and non-reimbursable costs.
4. Confirm that the costs are reasonable, using the definitions for reasonable and allocable as contained in Federal OMB Circular A-122 and, where appropriate, market prices, and actual costs. Keep in mind the notion of "moderate".
5. Confirm that the costs are not non-reimbursable costs under 808 CMR 1.05.
6. When in doubt about the reimbursability of particular costs, discuss the matter with your Department and, where appropriate, the Division of Purchased Services or the Department of Education.

A035-97
10/02/97

DPS-A034-97
August 1993
Update Note: July 1997

DIVISION OF PURCHASED SERVICES
SUMMARY SHEET:

RELATED PARTIES

NOTE: This document was originally prepared in August 1993 and its contents remain current as of July 1997, except the reference to citations in 808 CMR 1.00 have been updated to reflect the February 1997 version of the regulation.

WHEN DID ORGANIZATIONS BEGIN PROMULGATING RELATED PARTY CRITERIA?

FEDERAL AGENCIES : Securities and Exchange Commission >>1934
IRS >>1954

STATE AGENCIES : Attorney General >>1980
Rate Setting Commission >>1980
Division of Purchased Services >>1991

PROFESSIONAL ASSOCIATIONS : AICPA >>FASB 57, March 1982

WHAT ARE CURRENT SOURCES OF INFORMATION FOR PROVIDERS OF SOCIAL SERVICE PROGRAMS TO COMMONWEALTH PURCHASING AGENCIES?

- Directions to the Uniform Financial Statements and Independent Auditor's Report for Fiscal Year 1997
- Regulation 808 CMR 1.00, sections 1.02, 1.04(4), 1.04(11)(c) and 1.05
- Guidance Package from DPS on Related Party Relationships and Disclosure under 808 CMR 1.02 and 1.04(4)

WHY IS THE DISCLOSURE OF RELATED PARTY TRANSACTIONS NEEDED?

An organization's financial report users (regardless of whether that organization is for-profit or not-for-profit) need to know if all of the organization's relationships and transactions were carried out on an arm's length basis, as an arm's length basis is a prerequisite for competitive and free market dealings. Investors, lenders, and contributors assume that business is conducted on an arm's length basis and they assess the organization's activities with this assumption in mind. Where business is not conducted

at arm's length, for the information contained in an organization's financial reports to be meaningful, the reports must disclose the nature and extent of any ownership and management influence and control on the organization's activities.
Public taxing and regulatory bodies who are concerned with the payment of taxes and the reimbursement of costs with public funds need to know if all of the organization's relationships and transactions were carried out on an arm's length basis, as a requisite for determining the extent of tax liability and appropriateness of reimbursement demands. Taxing authorities need to determine that all appropriate taxes have been paid by the organization and its related entities. Regulatory bodies need to determine that only appropriate reimbursements have been made to the organization and its related entities.

WHAT IS A GENERAL DEFINITION OF A RELATED PARTY?

A related party has the ability to significantly influence ("control"), directly or indirectly, through ownership, contracts or other methods, the policies or actions of another organization or the management of another organization. In the case of Commonwealth human and social service contractors, it may be that another organization is able to influence the organization with whom the Commonwealth is doing business or it may be that the Commonwealth contractor is able to influence an organization with whom it is doing business and with whom the Commonwealth is not directly doing business.

HOW DO THE AUTHORITIES ESTABLISH IF INFLUENCE EXISTS?

Each of the pronouncements issued by the authorities listed previously provides guidance for determining what conditions could result in the ability to influence the policies and actions of others. For instance, the IRS indicates that transactions are considered related when they are associated with the following relationships:

Husband, Wife and Relationships

Grantor and Fiduciary

Grantor and Beneficiary

Fiduciary and Beneficiary, Legatee, or Heir

Decedent and Decedent's Estate

Partner, or

Member of an Affiliated Group of Corporations (A test for consolidation within 5 years, certain ownership, voting stock, and board membership is applied to for-profit corporations, trusts and charitable corporations to determine affiliations)

WHAT ASPECTS OF OTHER ORGANIZATION'S PRONOUNCEMENTS HAVE BEEN ADOPTED BY THE DIVISION OF PURCHASED SERVICES ?

DPS's provisions incorporate all of the provisions of the AICPA and the additional prior written disclosure requirements of 808 CMR 1.04(4).

WHAT ARE THE UFR DISCLOSURE REQUIREMENTS?

Human and social service organizations that contract with the Commonwealth and file the Uniform Financial Statements and Independent Auditor's Report (UFR) are audited in accordance with generally accepted government auditing standards (GAGAS) and are subject to various Commonwealth and Federal regulatory and contract provisions. In audits conducted pursuant to government auditing standards as in the Commonwealth social service contracting system, the materiality level and threshold for related party disclosure is lower than in similar-type audits in the private sector because of the necessity for public accountability of the entity, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions.

The following DPS related party disclosure guidance should assist in determining if disclosure is warranted in the notes to the financial statements of the UFR:

Programs and Supporting Services Purchased by the Commonwealth :

Generally, all related party relationships or transactions as defined in 808 CMR 1.02 that are associated with programs purchased by the Commonwealth (state agencies and local education authorities) are considered material and must be disclosed in the UFR notes to the financial statements. Two exceptions to this consideration, to the extent allowed by the qualitative materiality factors of GAGAS, include the following:

1) Individual or aggregated monetary related party transactions of less than one hundred dollars ($100) where the amount was defrayed by funds not derived from the Commonwealth.

2) Gifts furnished to the provider by an official, administrator or manager of the provider.

The sensitive nature of Commonwealth-purchased programs and the penalties and sanctions associated with failure to disclose related party transactions and relationships, including disallowance of related party costs and fines which could materially affect the financial statement amounts, dictate that related party relationships or transactions be considered material in accordance with GAGAS.

Programs and Supporting Services not Purchased by the Commonwealth:

All material related party transactions that are not associated with programs purchased by the Commonwealth or that could affect the provider's financial statements and all instances of common ownership or management control relationships for which 808 CMR 1.02 and the AICPA Statement of Financial Accounting Standards No. 57 (SFAS No. 57) require disclosure, even though there are no transactions, should be disclosed in the UFR notes to the financial statements. One exception to this consideration may, to the extent allowed by the qualitative materiality factors of GAGAS, include: Gifts furnished to the provider by an official, administrator or manager of the provider.

The materiality of related party transactions should be determined in accordance with the criteria established for materiality and significance in the field work standards of GAGAS.

The notes to the financial statements of the UFR should disclose material (GAGAS definition of material) related party relationships and transactions. The form of the disclosure of material related party transactions should meet the following requirements that have been derived from SFAS No. 57:

a. Nature of related party relationship;

b. The receivables or payables associated with related party transactions for each period that the balance sheet or program budget is presented, and if not clearly determinable, the conditions and methods of settlement;

c. For each period that an income statement or program budget is presented, the following is required:

   (1) A description of transactions and other necessary information needed for an understanding of the impact of the transactions; and

   (2) The dollar amounts assigned to transactions, and the impact of determining the terms of the transactions, if different from prior periods;

d. If two or more companies are under common control via ownership or management, the disclosure in a. above is required, even though no transactions occurred, if the existence of that control could result in operating results or a financial position significantly different from that which would have been obtained if the enterprises were autonomous.

NOTE: Preparers of the UFR should seek assistance from their independent auditor regarding appropriate interpretation of the requirements of 808 CMR 1.02 and the form and content of disclosure as noted above.

f:\[redacted]

AUDIT RESOLUTION POLICY
FOR
HUMAN AND SOCIAL SERVICES

Issued by: **Division of Purchased Services (DPS)**
Operational Services Division
Updated: **1/1/98**

The Division of Purchased Services (DPS) Audit Resolution Policy provides policy and procedures for use by Departments and Contractors to address the findings and recommendations in independent auditor's reports issued in accordance with Generally Accepted Government Auditing Standards (GAGAS) and where follow-up is necessary. This policy is issued pursuant to 808 CMR 1.04(10), which requires DPS to maintain an audit resolution policy for audits of Contractors delivering human and social services and Contractors operating M.G.L. c.71B programs. For both Contractors and Departments, these audits serve as an important feedback mechanism on the management and financial operation of government funded programs. Audit resolution, thus, becomes a vital management tool to strengthen not only individual programs and agencies, but the entire Purchase-of-Service (POS) system. Departments are expected to assign a high priority to the resolution of audit recommendations and to corrective action related to findings contained in GAGAS independent auditor's reports. OMB Circular A-133 audits must be resolved in accordance with the additional provisions of OMB Circular A-133 as amended.

AUDIT RESOLUTION SYSTEM

The system that Departments establish for audit resolution and corrective action must meet the standards listed below:

Department Audit Resolution System

1. *Manager*: A senior level official of the purchasing Department must be appointed to manage the system established for audit resolution and corrective actions.
2. *Management Decisions*: Department management decisions must entail an evaluation of the audit findings and corrective action plan and the issuance of a written decision as to what corrective action is necessary.
3. *Lead Agency*: Resolution and corrective action on recommendations involving more than one purchasing Department must be resolved and coordinated by the principal purchasing agency (PPA) as designated by the applicable Secretariat.
4. *Communication:* Purchasing Departments or principal purchasing agencies, as applicable, must provide a copy of the administrative agreement containing the corrective action plan and management decisions to DPS and the appropriate Secretariat.
5. *Referrals:* The Department is responsible for referring audit findings not subject to Department oversight responsibility to appropriate oversight entities.

Corrective Action Plan (CAP) Requirements

1. *Written Plan*: At the completion of the Uniform Financial Statements and Independent Auditor's Report (UFR) and/or the OMB Circular A-133 audit, the Contractor shall prepare a written corrective action plan to be submitted together with the audit. Written corrective action plans must be prepared and submitted by the Contractor after it receives a final audit report issued by the Office of the State Auditor (OSA) or by a Department contracted auditor.

2. *Content:* The corrective action plans must address all audit findings included in each of the independent auditor's reports issued by the Office of the State Auditor or issued in accordance with OMB Circular A-133. For non A-133 UFRs and Department contracted audits, DPS recommends that the corrective action plan address all audit findings as well; however, it is mandatory only for material non-compliance findings and reportable condition internal control findings (which includes material weaknesses). Immaterial non-compliance findings and non-reportable internal control findings are normally disclosed in a management letter but may also or instead be reported in GAGAS independent auditor's reports. When such findings are included in the auditor's report, they must be included in the CAP for A-133 or SAO audits and are encouraged to be included for non-A-133 audits. See Chart 1 for details.

Types of Audits	Audit Findings Which Require Resolution		
	Compliance Report	**Internal Control Report**	**Management Letter**
	M = Material Non-compliance *IM = Immaterial Non-compliance*	*R = Reportable Condition* *MW = Material Weakness* *NR = Non-reportable Condition*	*IM = Immaterial Non-compliance* *NR = Non-reportable conditions*
A-133	All	All	None
SAO	All	All	None
UFR and other non A-133	M (IM - recommended)	R and MW (NR - recommended)	None

3. *Format*: Corrective action plans shall identify the findings, deficiencies, uncorrected prior audit findings and reference numbers utilized by the independent auditor to identify the findings. Corrective actions to be taken, along with specified action dates, must be identified in the corrective action plan and approved by the Contractor's board of directors.

Department Management Decisions

1. *Requirements:* Department management decisions and corrective actions must be consistent with law, regulations, contract terms and conditions and policies established by the Department, Secretariat, DPS, the federal government and other oversight entities as applicable. Written justification supported by sufficient, competent and relevant evidence must account for the legal basis for any decisions not agreeing with the independent auditor's findings and recommendations. Evidence that was not available for review by the independent auditor during the field work stage of the audit and which the auditor indicated may be relevant to the audit findings, may be reviewed and utilized for making management decisions. However, evidence that was available but not furnished to the auditor as requested by the auditor during the field work stage of the audit may not be reviewed or considered in making management decisions.
2. *Legal Review:* Management decisions not to collect funds in whole or in part related to non-reimbursable cost overpayments (Questioned Costs) and cost reimbursement contract overpayments must be reviewed by the legal counsel of the purchasing Department, the applicable Secretariat and DPS's audit and legal staff for appropriateness. Decisions not to collect these funds and to write them off as Commonwealth bad debts must be authorized by DPS, the applicable Secretariat, Office of the Comptroller and applicable federal cognizant

and oversight agencies and the President's Office of Management and Budget, as appropriate.

3. *Administrative Agreement:* The corrective action plan and purchasing Department management decisions must be incorporated into an administrative agreement signed by the authorized signatory of the Contractor and the purchasing Department or the principal purchasing agency's representative, as applicable.
4. *Oversight Response:* Federal cognizant and oversight agencies, DPS and the appropriate Secretariat may review written corrective action plans and management decisions and issue additional management decisions that include further actions necessary to correct deficiencies and resolve audit findings.

Timelines

1. *Initiation of audit resolution:* The Department must require prompt resolution and corrective action on audit recommendations. The Department must issue a management decision on audit findings within six months after receipt of the Contractor's audit report and corrective action plan, and ensure that the Contractor takes appropriate and timely corrective action. Corrective action should proceed as rapidly as possible.
2. *Department process:* The purchasing Department must provide a means to ensure timely responses to the independent auditor's reports if Contractor responses have not been incorporated into the independent auditor's reports. The process must provide sufficient time to permit resolution to take place within the six-month period.
3. *Corrective Action:* Corrective actions should be accomplished within a reasonable period of time and generally prior to the termination of the contract and federal award related to the finding. Departments must take all actions necessary to ensure that corrective actions are accomplished, whenever possible, prior to the termination of all contracts and agreements or federal awards with the Contractor.

Purchasing Departments are expected to place a high priority on audit resolution and to complete the process quickly. Contractors are expected to cooperate with audit resolution efforts to initiate corrective actions. Independent auditors are responsible for follow-up on audit findings and corrective actions. Disagreements between Departments, Contractors and independent auditors are to be resolved by DPS. Questions concerning any aspect of the DPS Audit Resolution policy may be directed to the Bureau of Audit at 617-727-7500.

AUDIT RESOLUTION STANDARDS

A. Non-Performance

Non-performance under contracts means services were not delivered or the services that were delivered did not meet standards established by the purchasing Department in the contract. In the event of non-performance, recovery of funds is appropriate. Depending on the circumstances and severity of the problem, Departments may also need to consider reduction or termination of contracts, debarment or other legal remedies. Once a determination of non-performance is made, the focus should be on the manner of resolution which is most appropriate under the circumstances and, if not already determined, the value of services which were not rendered.

B. Fraudulent Billing

All reimbursements to a Contractor which have been determined to be supported by fraudulent documentation will be disallowed. Funds fraudulently acquired must be promptly recovered in full and returned to the Commonwealth. All such cases will be referred to the offices of the State

Auditor, the Attorney General, and the Inspector General and, if federal funds are involved, to the appropriate federal Inspector General and U.S. Attorney.

C. Undocumented Reimbursement

Under all contracts (regardless of the reimbursement mechanism), Contractors must maintain appropriate documentation of actual reimbursable operating costs, revenues, service provision and performance attained in accordance with the requirements established by federal and state regulations and laws, terms of the contract, Division of Health Care Finance and Policy regulations (if applicable), and the policies of the purchasing Department. When there is a determination that there was a failure to maintain adequate and appropriate documentation, depending upon the circumstances, resolution may occur through recovery of funds or a rate adjustment. For instance, undocumented costs are considered non-reimbursable costs pursuant to 808 CMR 1.05 (26), Undocumented Expenses, and they are normally subject to recoupment unless alternative evidence is produced to substantiate that the costs were actually incurred. In the case of non cost reimbursement contracts, other evidence, in the form of credible and convincing alternative documentation, that the services in question were actually provided and the type and amount of costs were actually incurred during the contract period will be considered. In such cases, however, in order to prevent re-occurrence of recordkeeping deficiencies in subsequent years, a satisfactory, written resolution of all such audit determinations must have been reached.

D. Non-Reimbursable Expenses

Under all contracts, reimbursement to Contractors is permitted only for actual reimbursable operating costs incurred (as defined in 808 CMR 1.02) for the contract, based on terms of the contract, Division of Health Care Finance and Policy requirements, and/or purchasing Department requirements. Non-reimbursable costs (as defined in 808 CMR 1.05) that are defrayed using Commonwealth funds and offsetting revenue (intended for use in defraying reimbursable costs), as designated in the contract or as required by 808 CMR 1.00 or OMB Circular A-110 (program income as applicable), are subject to recovery through recoupment, delivery of in-kind services or rate adjustment, in accordance with 808 CMR 1.05. In-kind services furnished by the Contractor in lieu of recoupment or rate adjustment must result in the Contractor incurring additional program costs equal to the value of the non-reimbursable costs. In addition, in-kind service costs must be defrayed with funds other than Commonwealth funds and offsetting revenue, as designated in the contract or as required by 808 CMR 1.00 or OMB Circular A-110 (program income as applicable). In-kind services may only be delivered to eligible clients of the Department.

E. Billing Errors

Errors in invoices submitted to the Commonwealth for reimbursement, which do not constitute fraud, will be referred to the purchasing Department to be rectified in the most appropriate manner possible under the circumstances.

F. Under-utilization of Staffing Resources

This provision is intended to be utilized when there are indications that staffing may not have been provided as agreed upon in the original contract or amendment documents as needed to carry out the program of services. For purposes of this section, emphasis should be placed upon the review of staff credentials and full-time equivalents (FTEs) provided. Review of the cost of staffing shall take into consideration payroll, the cost of relief staff and consultants, compensated overtime performed by existing staff, related taxes, related benefits, and the like. For purposes of resolving audit findings concerning reimbursement, a determination that any program or cost category for staff related spending was below 90 percent of the funds budgeted or allocated for staffing in the relevant contract, shall be referred to the purchasing Department for review of

actual service delivery and quality levels. Purchasing Departments are responsible for resolving the deficiency by determining if service delivery requirements, performance standards and/or minimum staffing or program standards have been met or need to be revised.

G. Over-billing in Cost Reimbursement Contracts

The provisions of MGL c.29, s. 22 and other state finance laws limit payments from the Commonwealth in the year funds were appropriated to the amount necessary to meet expenses incurred in that year. Accordingly, all cost reimbursement contract payments from the Commonwealth that exceed expenses incurred by the Contractor in the year appropriated must be recovered. Current state finance law limits methods of recovering surplus funds in cost reimbursement contracts to the establishment of a reasonable schedule of Contractor repayments to the Commonwealth. In addition, when expenses are undocumented in cost reimbursement contracts, other evidence (in the form of alternate documentation) cannot be considered and recovery of funds is appropriate as a basis of resolution.

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COMMONWEALTH OF MASSACHUSETTS
STANDARD CONTRACT FORM

This form is jointly issued by the Executive Office for Administration and Finance (ANF), the Office of the Comptroller (CTR) and the Operational Services Division (OSD) for use by all Commonwealth Departments. **Any changes to the official printed language of this form as published by ANF, CTR and OSD shall be void. This shall not prohibit the addition of non-conflicting Contract terms.** The quality of all performance by the Contractor under this Contract must be timely and meet or exceed industry standards. The Contractor shall comply with all applicable Massachusetts ("State") and federal laws and regulations and perform this Contract in accordance with the applicable Commonwealth Terms and Conditions and as follows:

(The Contractor Must Complete Only Those Sections preceded by an ">>")

>>Vendor Code:	Document ID:
>>**CONTRACTOR NAME:**	**DEPARTMENT NAME:**
>>Contract Manager:	Contract Manager:
>>Phone: >>Fax:	Phone: Fax:
>>Business and Mailing Address:	Business and Mailing Address:
Terms and Conditions that apply to this Contract (*Completed by Department. Check one option only*): ___ COMMONWEALTH TERMS AND CONDITIONS (Standard) OR x_ COMMONWEALTH TERMS AND CONDITIONS FOR HUMAN AND SOCIAL SERVICES **Execution and Filing Status of applicable Terms and Conditions:** *(Check one option only):* __x_ Previously executed by Contractor and is on file as prescribed by CTR OR ___ Executed by Contractor and is attached to this Contract	**Compensation** (*Completed by Department*) __x_ Maximum Obligation of this Contract: $_____. OR ____ No Maximum Obligation established: ___ Rate Contract with a Rate of: $_____ ___ Per:_____ (Multiple Rates Must Be Attached) ___ Statewide Contract or Qualified List Contract **Payment Type**: FOR INFORMATION PURPOSES ONLY (*Completed by Department- Check one option only*) ___Payment Voucher X Ready Payment (Schedule: SALR__Initial Base Amt:_50%__) ____Contractor Payroll ____Recurring Payment
Start Date of This Contract:_____7/1/97_____ (*Completed by Department.* Subject To Section 1. of the applicable Terms and Conditions.)	**(Termination Date of This Contract** :_____6/30/98_____. (*Completed by Department.* Subject To Section 4. Of the applicable Terms and Conditions.)

Brief Description of Performance: (*Completed by Department*) Attach a copy of the Request for Response (RFR) and the Contractor's Response and any additional negotiated terms, if applicable; or if an RFR was not required attach appropriate justification documentation including exemption from RFR requirement and details of scope of performance and compensation.

Program Code: SALR FY'98 Direct Care Salary Reserve Contract.

Pursuant to Chapter 43 of the Acts of 1997, item 1599-6896, the terms of the Operational Services Division FY'98 Salary Reserve Implementation Plan, and Attachment A, this contract is to fund the cost of a salary increase for the period July 1, 1997 to June 30, 1998 for eligible direct care employees and supervisory staff earning less than $30,000 in annual compensation who work in programs under the Departmental contracts listed in Attachment A.

IN WITNESS WHEREOF, the Contractor certifies, under the pains and penalties of perjury that it is in compliance with all of the following provisions and shall remain in compliance with these provisions for the life of this Contract: That the Contractor is qualified to perform this Contract and possesses, or shall obtain, all requisite licenses and permits to complete performance under this Contract; that it is in compliance with all federal and state tax laws, including M.G.L. c. 62C, §49A; that pursuant to M.G.L. c. 151A, §19A and M.G.L. c. 152, it will comply with all laws and regulations relating to payments to the Employment Security System and required workers' compensation insurance policies; that it shall carry professional and personal injury liability insurance sufficient to cover its performance under this Contract; that it will comply with all relevant prevailing wage rate and employment laws; that it is in compliance with the provisions of the Acts of 1990, c. 521, §7 as amended by the Acts of 1991, c. 329 and 102 CMR 12.00 and that the Contractor is either a "qualified employer" (it has fifty (50) or more full time employees and has established a dependent care assistance program, child care tuition assistance, or on-site or near-site child care placements) or the Contractor is an "exempt employer"; that pursuant to M.G.L. c. 156B, §109 (business corporations), c. 180, §26A (non-profit corporations), c. 181, §4 (foreign corporations) and c. 12, §8F (public charities) it has filed all required certificates and reports with the Secretary of State and the Attorney General's Office; that it is in compliance with Federal Anti-Lobbying requirements of 31 USC 1352; that it and any of its subcontractors are not currently debarred or suspended by the federal government or the State under any law or regulation, including Federal Executive Orders 12549 and 12689, Executive Order 147, M.G.L. c. 29, §29F and M.G.L. c. 152, §25C; and that it shall comply with Executive Orders 130, 346 and 359, M.G.L. c. 268A, c. 7, §22C and any additional provisions specified in this Contract, and **IN WITNESS WHEREOF, the Contractor certifies under the pains and penalties of perjury that it has submitted a Response to a Request for Response (RFR) issued by the Department and that this Response is the Contractor's offer as evidenced by the execution below of the Contractor's authorized signatory, and that this Response may be subject to negotiation by the Department, and that the terms of the RFR, the Contractor's Response and any negotiated terms of the Response shall be deemed accepted by the Department and included as part of this Contract, which incorporates by reference the applicable Terms and Conditions, upon execution of this Contract by the Department's authorized signatory as of the date indicated below, OR if this Contract is not the result of a Request for Response solicitation that this Contract complies with all applicable laws and regulations as indicated by the execution of the authorized signatories of the Department and the Contractor as of the last date indicated below:**

FOR THE CONTRACTOR:	**FOR THE DEPARTMENT:**
>>X:_____ (Signature)	**X:**_____ (Signature)
>>NAME: _____	**NAME:** _____
>>TITLE: _____	**TITLE:** _____
>>DATE: _____	**DATE:** _____

FY'98 Direct Care Salary Reserve Contract
Attachment A

>>Vendor Code:	Document ID:
>>CONTRACTOR NAME:	DEPARTMENT NAME:

Pursuant to Chapter 43 of the Acts of 1997, item 1599-6896, the terms of the Operational Services Division (OSD) FY'98 Reserve Implementation Plan, the Commonwealth Terms and Conditions for Human and Social Services, the Standard Co Form and Attachment A, this contract is to fund the cost of a salary increase for the period July 1, 1997 to June 30, 19 eligible direct care employees and supervisory staff earning less than $30,000 in annual compensation who work in pro under the following eligible Department contracts:

_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

The Fiscal Year 1998 maximum obligation of this agreement is $_____, and covers the contracts listed above. sum was determined based on survey data submitted by the Contractor and the allocation plan developed by OSD. The app OSD/DPS allocation schedule and associated backup data pursuant to the OSD FY'98 Salary Reserve Implementation Plan shall se documentation for payment of these funds.

By signing the Standard Contract Form, the Contractor certifies, under the pains and penalties of perjury that it shal comply with all of the following provisions and shall remain in compliance with these provisions for the life of this agreement

1) The Contractor submitted valid, accurate salary survey data and only eligible contracts are listed;
2) All funds received through this agreement will be used only for salary increases and the employer portion of payroll taxes di associated with the salary increases for eligible direct care employees and supervisory staff earning less than $30,000 in a compensation in programs funded by the above cited contracts, in accordance with the provisions of St. 1997, c.43, s.2, item 1 6896 and the OSD FY'98 Salary Reserve Implementation Plan and this Attachment A;
3) The Contractor may set aside up to 15% of its allocation (which is the total maximum obligation of this agreement) for asso increases in payroll-related taxes (FICA, unemployment insurance, and workers' compensation insurance);
4) Based on the actual allocation received, the Contractor may give each eligible employee either (a) the same percentage increa (b) the same fixed dollar increase (pro-rated for part-time employees) to their salary such that the annualized cost for all s increases and associated payroll taxes does not exceed the FY'98 reserve award;
5) Reserve funds that would otherwise go unspent because of staff turnover or re-deployment may used at the Contractor's disc for eligible employees during FY'98 only;
6) Salary increases are retroactive to July 1, 1997, where appropriate;
7) Payments to eligible employees should begin no later than October 1, 1997 or within 10 days of receipt of these funds b Contractor, whichever is later;
8) Employees whose employment with the Contractor ended prior to the execution of this agreement need not receive a portion c funds;
9) The Contractor need not give increases to employees whose performance was rated unsatisfactory on their most recent perfor appraisal or who are currently subject to disciplinary action.
10) The Contractor must maintain until June 30, 2005, detailed data to support the salary survey submission and document describing how the funds were actually distributed for all FY'98 Salary Reserve agreements;
11) Upon request of OSD or the Department, the Contractor must, within 30 days, submit data on the actual distribution of funds u this agreement;
12) In addition to all other rights granted to the Commonwealth under law and the Terms and Conditions for Human and Social Serv the Department, the Division of Purchased Services and the Office of the State Auditor or their designees may request inform and conduct inspections, desk reviews and audits of Contractor records to determine compliance with the terms of this agreemen
13) As part of the Contractor's Fiscal Year 1998 audit, the Contractor's independent auditor shall test for compliance with the ter this agreement. Should the Contractor fail to comply with any of the terms of this agreement the funds are subject to imme recoupment, through repayment by the Contractor, intercept through the Office of the State Comptroller, or such other actio may be necessary to recover such funds, costs or damages for breach of this agreement; and,
14) If the Contractor's allocation includes funds for a sub-contractor's eligible direct care workers and supervisory staff, the Contract required to disburse those funds and enter into a written agreement consistent with and subject to the same terms as this agree with its sub-contractor. The Contractor is responsible for assuring its sub-contractor's compliance with the terms of the agreeme

The parties do not intend to create any rights in direct care workers and supervisory staff to enforce this agreement.

COMMONWEALTH TERMS AND CONDITIONS FOR HUMAN AND SOCIAL SERVICES

This Commonwealth Terms and Conditions for Human and Social Services form is jointly issued by the Executive Office for Administration and Finance (ANF), the Office of the Comptroller (CTR) and the Operational Services Division/Division of Purchased Services (OSD), for use by Commonwealth of Massachusetts ("State") Departments and Contractor organizations that contract to provide Human and Social Services to Commonwealth clients. **Any changes or electronic alterations by either the Department or the Contractor to the official version of this form, as jointly published by ANF, CTR and OSD, shall be void.** Upon execution of these Commonwealth Terms and Conditions for Human and Social Services by the Contractor and filing as prescribed by CTR, these Commonwealth Terms and Conditions for Human and Social Services will be incorporated by reference into any Contract for Human and Social Services executed by the Contractor and any Department, in the absence of a superseding law or regulation requiring a different Contract form. Its provisions are in addition to the requirements contained in 808 CMR 1.00 and any Human and Social Services Contract(s), as well as any applicable requirements contained in 808 CMR 2.00 or 801 CMR 21.00. This Commonwealth Terms and Conditions for Human and Social Services is effective upon signature by the Contractor or July 1, 1997, whichever is later, and supersedes the Master Agreement and General Conditions approved by ANF on May 1, 1995.

1. Contract Effective Start Date. Notwithstanding verbal or other representations by the parties, unless otherwise permitted in 801 CMR 21.00, the effective start date of a Contract shall be the later of: the date the Contract was executed by an authorized signatory of the Contractor; the date the Contract was executed by an authorized signatory of the Department; the date specified in the Contract; or, the date of Secretariat authorization pursuant to M.G.L. c. 29, §29B.

2. Payments And Compensation. The Contractor shall only be compensated for performance delivered and accepted by the Department in accordance with 801 CMR 21.00, 808 CMR 1.00 and the specific terms and conditions of a Contract. All Contract payments are subject to appropriation pursuant to M.G.L. c. 29, §26, or the availability of sufficient non-appropriated funds for the purposes of a Contract, and shall be subject to intercept pursuant to M.G.L. c. 7A, §3 and 815 CMR 9.00. In no event shall payments under any Contract exceed the rate or maximum obligation of the Contract or be directed to off-set costs which are not reimbursable under Commonwealth contracts under any provision of law, including M.G.L. c. 7, §56 and 808 CMR 1.00. Upon determination by the Department that the Contractor has not provided services to the extent billed, has billed for services to any client who the Contractor knew or should have known was ineligible for services according to the terms of the Contract, has received duplicate or otherwise excess payments, has used Contract payments for non-reimbursable expenses or otherwise failed to perform in accordance with the terms of the Contract or 808 CMR 1.04, the Department may, upon reasonable notice and opportunity for correction, delay, disallow, set-off or recoup payments.

3. Contractor Payment Mechanism. The Contractor will be paid using the Payment Voucher System unless a different payment mechanism is agreed upon in the Contract. The Contractor shall timely submit invoices (Payment Vouchers - Form PV) and supporting documentation as prescribed in a Contract. The Department shall review and return rejected invoices within fifteen (15) days of receipt with a written explanation for rejection. Payments shall be made in accordance with the bill paying policy issued by the Office of the Comptroller and 815 CMR 4.00, provided that payment periods listed in a Contract of less than forty-five (45) days from the date of receipt of an invoice shall be effective only to enable a Department to take advantage of early payment incentives and shall not subject any payment made within the forty-five (45) day period to a penalty.

4. Contract Termination Or Suspension.

a. Procedures. A Contract shall terminate on the date specified in a Contract, unless this date is properly amended in accordance with all applicable laws and regulations prior to this date, or unless terminated or suspended under this Section upon any of the events or conditions set forth below. During the notice period for termination, the parties may agree to adjust the termination conditions, including the effective date contained within the notice of termination. Grounds and procedures for termination are: i) Immediate Termination: Absence of Funding or Emergency. A Contract shall terminate immediately upon receipt of written notice of termination under the following conditions: the absence of appropriation, allotment, availability or authorization to the Department to discharge its obligations under the Contract in the fiscal year; a party's default, breach or any intervening casualty which poses an immediate threat to the life, health or safety of a client; the indictment of the Contractor or one of its principals or officers for an offense or offenses related to the provision of services; fraudulent activities on the part of the Contractor in its dealings with the Commonwealth; or the filing for bankruptcy by a Contractor. ii) Early Termination: Breach or Default, Reduction of Funding or Change in Law. A Contract may be terminated by providing notice of termination effective not less than forty-five (45) calendar days after date of notice under the following conditions: either party may terminate if the other party fails to fulfill its obligations under a Contract, including partial or complete non-performance of any provision; there is a reduction of funds appropriated for Contracts; or if any statute or regulation which governs performance is changed, differently interpreted by a court or other competent authority, newly enacted, adopted or promulgated so as to increase the burdens on either party in complying with the terms of the Contract significantly beyond those existing at the time of execution. For termination for breach or default, the party must specify the alleged default or breach in writing, allowing a reasonable time, but not less than thirty (30) calendar days, for correction. For termination due to reduction in funding, the Department may alternatively provide a conditional notice of termination with a proposed amendment to a Contract. iii) Termination without Cause. Either party may terminate the Contract without cause upon provision of written notice to the other at least sixty (60) calendar days before its effective date. Whether or not cause to terminate exists under any other provision, a party may elect to terminate without cause.

b. Obligations Upon Termination. Upon termination, the Contractor shall have the following obligations: i) Transfer of Clients. The Contractor shall use its best efforts to provide for the health and safety of clients being served under the Contract for a reasonable period of time, while the Department arranges for their transfer, and shall cooperate fully with the Department's efforts to transfer clients. ii) Client Records. Client records maintained pursuant to the Contract shall remain the property of the Contractor, subject to the provisions of Sections 6, 7 and 11d. However, where the Department has continuing responsibility to provide for the clients funded by the Contract, the Contractor must, upon request, provide to the Department or the new Contractor a copy of the client records of services as authorized by the Department. The reasonable cost of such transfer will be borne by the Department. iii) Reports and Other Documents. All documents, data, studies, and reports related to performance of the Contract shall be submitted to the Department by the Contractor, unless the Department directs otherwise. iv) Furnishings and Equipment. The termination of the Contract does not affect the Contractor's responsibilities with respect to equipment and other property under 808 CMR 1.00. v) Payment. The Contractor shall be paid for all authorized services performed up to the date of termination, subject to the provisions of Section 2. In addition, if the Department is required to remove clients from a facility operated by the Contractor and fails to remove said clients, unless otherwise agreed by the parties and subject to the conditions set forth in Section 2, the Contractor will be paid at the rate contained in its terminated Contract for continuing to provide services after the date of termination and until such clients are removed. vi) Subsequent Audit. If a Contract is terminated without inspection, review or audit, the Commonwealth retains the right to conduct an inspection, review, or audit and to disallow reimbursement or recover funds if any finding warrants such action.

5. Written Notice. Any notice shall be deemed delivered and received when submitted in writing, in person or when delivered by any other appropriate method evidencing actual receipt by the Department or the Contractor.

6. Confidentiality. The Contractor shall comply with M.G.L. c. 66A if the Contractor becomes a "holder" of "personal data". The Contractor shall also protect the physical security and restrict any access to personal or other Department data in the Contractor's possession, or used by the Contractor in the performance of a Contract, which shall include, but is not limited to the Department's public records, documents, files, software, equipment or systems.

7. Record-keeping And Retention. Inspection Of Records. The Contractor shall maintain records, books, files and other data as required by 808 CMR 1.00 and as specified in a Contract and in such detail as shall properly substantiate claims for payment under a Contract, for a minimum retention period of seven (7) years beginning on the first day after the final payment under a Contract, or such longer period as is necessary for the resolution of any litigation, claim, negotiation, audit or other inquiry involving a Contract. The Contractor shall maintain adequate written policies and procedures for accounting, management and personnel activities, including but not limited to conflict of interest and nepotism policies. The Department shall have access, as well as any parties identified under Executive Order 195, during the Contractor's regular business hours and upon reasonable prior notice, to such records, including on-site reviews and reproduction of records at a reasonable expense.

8. Assignment. No liability, responsibility, obligation, duty or interest under a Contract may be assigned, delegated, assumed or transferred, in whole or in part, without the prior written approval of the Department. However, the Contractor or a court appointed receiver shall be authorized to assign present and prospective claims for money due to the Contractor pursuant to a Contract in accordance with M.G.L. c.106, §9-318. The Contractor or court appointed receiver must provide sufficient notice of assignment and supporting documentation to enable the Department to verify and implement the assignment. Payments to third party assignees will be processed as if such payments were being made directly to the Contractor and these payments will be subject to intercept, offset, counter claims or any other Department rights which are available to the Department or the State against the Contractor.

9. Subcontracting By Contractor. Any subcontract entered into by the Contractor for the purposes of fulfilling the obligations under a Contract must be in writing, authorized in advance by the Department and shall be consistent with and subject to the provisions of these Commonwealth Terms and Conditions for Human and Social Services and a Contract. When the Department furnishes federal funds to the Contractor, which are being passed down to a subcontractor, the subcontract must contain a provision that the subcontractor will comply with applicable federal single audit, cost principles and administrative requirement standards. Subcontracts will not relieve or discharge the Contractor from any duty, obligation, responsibility or liability arising under a Contract. The Department is entitled to copies of all subcontracts and shall not be bound by any provisions contained in a subcontract to which it is not a party.

10. Affirmative Action, Non-Discrimination In Hiring, Employment and Service Delivery. The Contractor shall comply with all federal and state laws, rules and regulations promoting fair employment practices or prohibiting employment discrimination and unfair labor practices. The Contractor shall not discriminate in the delivery of services against any person who otherwise meets the eligibility criteria for services, or in the hiring of any applicant for employment nor shall any qualified employee be demoted, discharged or otherwise subject to discrimination in the tenure, position, promotional opportunities, wages, benefits or terms and conditions of their employment because of race, color, national origin, ancestry, age, sex, religion, disability, status as a Vietnam Era Veteran, sexual orientation or for exercising any rights or benefits afforded by law. The Contractor commits to purchasing supplies and services from certified minority or women-owned businesses, small businesses or businesses owned by socially or economically disadvantaged persc persons with disabilities and agrees to comply with any affirm action programs required by Executive Order 227, or any succ provisions

11. Human and Social Services Contracting Provisions

a. Board of Directors Standards. If a non-profit organization Contractor shall comply with the principles in the Massachu Attorney General's "Guide for Board Members of Chari Organizations" and with the standards for boards contained in American Institute of Certified Public Accountants (AICI statements on auditing standards, as may be amended from time to Further, the Contractor specifically agrees that: i) members o Contractor's management and immediate family (as defined in AICPA's Financial Accounting Standards Board Statement numbe will not comprise more than 30% of the voting members of Contractor's board or any of the board's committees or subcommit and, ii) the Contractor's Board of Directors will approve the selectio the Contractor's audit firm, will annually review its executive direc or other more senior manager's performance and set that pers compensation by formal vote, and will meet as frequently as neces to fulfill the Contractor's obligations under this section. Where board meets less than two times during its fiscal year, the Contra shall submit a description of its board structure and the dates of board and subcommittee meeting with its Uniform Financial Statem and Independent Auditor's Report (UFR).

b. Client Care and Use of Funds. The Contractor shall comply wit applicable provisions of law relative to the care of clients and investigation and reporting of suspected client abuse or neglect. Contractor shall provide the Department with copies of all leg mandated reports of client abuse or neglect where the alleged abus neglect was a direct or indirect consequence of the services rend under a Contract and shall comply with all additional repor requirements relative to client abuse and neglect contained in a Conti The Contractor shall be subject to any standards cited in a Contract the disqualification of candidates for positions where the candid have criminal records, for establishing proof of criminal rec information of candidates prior to hire and for addressing crim activities subsequent to hire. The Contractor shall also comply with laws and regulations and contractual provisions relative to the use client funds, property or other resources.

c. Annual Financial Reporting Requirements. The Contractor and subcontractor must comply with all applicable annual financial repor requirements set forth in 808 CMR 1.00 and the instructions to the U Any nonprofit Contractor receiving in excess of the threshold of fed funds through the Commonwealth, as set forth in Office of Managem and Budget (OMB) Circular A-133 or successor provision, must com with the Circular as well.

d. Publications. The Contractor shall not disseminate, reprodu display or publish any report, map, information, data or other mater or documents expressly required or produced in whole or in p pursuant to a Contract, nor shall any such materials or documents be subject of an application for patent or copyright by or an behalf of Contractor, without the prior written consent of the Department. If Contractor prepares, publishes or distributes any publication describ any services or programs the cost of which are funded at least in part a Contract, then any such publication shall, unless the Departm directs otherwise, contain a prominently displayed statement to t effect.

e. Additional Provisions Applicable to Contractors Receivi Federal Funds. If the Contractor receives federal funds from Commonwealth through a Contract, then, in accordance with OM Circular A-110 or successor provision, it further agrees to the followi i) Equal Employment Opportunity: All contracts entered into by Contractor shall contain a provision requiring compliance with fede Executive Order 11246, as amended by Executive Order 11375, and supplemented by regulations at 41 CFR part 60; ii) Contract Wc Hours and Safety Act: If the Contractor employs mechanics or labor to fulfill its contractual obligations, it will comply with sections 102 a

COMMONWEALTH TERMS AND CONDITIONS FOR HUMAN AND SOCIAL SERVICES

107 of 40 USC 327-333, as supplemented by 29 CFR part 5.; iii) Clean Air Act and the Federal Water Pollution Control Act: If the Contractor receives more than $100,000 in federal funds the Contractor agrees to comply with any applicable standards, order, or regulations issued pursuant to 42 USC 7401 et seq. and 33 USC 1251 et seq.; and iv) Byrd Anti-Lobbying Amendment: If a Contractor receives $100,000 or more of federal funds through a Contract, by signing that Contract it certifies it has not and will not use federal appropriated funds to pay any person or organization for influencing or attempting to influence an officer or employee of any agency, a member of Congress, an officer or employee of Congress or an employee of a member of Congress in connection with obtaining any federal contract, grant or any other award covered by 31 USC 1352. A Contractor shall disclose any lobbying with non-federal funds that takes place in connection with obtaining any federal award.

12. Waivers. Forbearance or indulgence in any form or manner by a party shall not be construed as a waiver, nor in any way limit the legal or equitable remedies available to that party. No waiver by either party of any default or breach shall constitute a waiver of any subsequent default or breach.

13. Risk Of Loss. The Contractor shall bear the risk of loss for any Contractor supplies, equipment or other materials used for a Contract and for all deliverables, records, documents, files, data, studies and reports which are in the possession of the Contractor or used by the Contractor in the performance of a Contract until possession and, where applicable, ownership and full legal title, to the deliverables, records, documents, files, data, studies and reports are transferred to and accepted by the Department.

14. Forum and Choice of Law. Any actions arising out of a Contract shall be governed by the laws of Massachusetts, and shall be brought and maintained in a State or federal court in Massachusetts which shall have exclusive jurisdiction thereof.

15. Contract Boilerplate Interpretation, Severability, Conflicts With Law, Integration. Any amendment or attachment to any Contract which contains conflicting language or has the effect of deleting, replacing or modifying any printed language of these Commonwealth Terms and Conditions for Human and Social Services, as officially published by ANF, CTR and OSD, shall be interpreted as superseded by the official printed language. If any provision of a Contract is found to be superseded by state or federal law or regulation, in whole or in part, then both parties shall be relieved of all obligations under that provision only to the extent necessary to comply with the superseding law, provided however, that the remaining provisions of the Contract, or portions thereof, shall be enforced to the fullest extent permitted by law. All formal amendments must be executed by the parties and filed with the original record copy of a Contract as prescribed by CTR. The printed language of the Standard Contract Form, as officially published by ANF, CTR and OSD, which incorporates by reference these Commonwealth Terms and Conditions for Human and Social Services, shall supersede any conflicting verbal or written agreements relating to the performance of a Contract, or attached thereto, including contract forms, purchase orders or invoices of the Contractor. The order of priority of documents to interpret a Contract shall be as follows: the printed language of the Commonwealth Terms and Conditions for Human and Social Services, the Standard Contract Form, the Department's Request for Response (RFR) solicitation document and the Contractor's Response to the RFR solicitation, excluding any language stricken by a Department as unacceptable and including any negotiated terms and conditions allowable pursuant to law or regulation.

IN WITNESS WHEREOF, The Contractor certifies under the pains and penalties of perjury that it shall comply with these Commonwealth Terms and Conditions for Human and Social Services for any applicable Contract executed with the Commonwealth as certified by its authorized signatory below:

CONTRACTOR AUTHORIZED SIGNATORY: _____
(signature)

Print Name: _____

Title: _____

Date: _____

Full Legal Organization Name: _____

Doing Business As: Name (If Different): _____

Tax Identification Number: ___ ___ ___ ___ ___ ___ ___ ___ ___

Address: _____

_____

Telephone: _____ FAX: _____

INSTRUCTIONS FOR FILING THE COMMONWEALTH TERMS AND CONDITIONS FOR HUMAN AND SOCIAL SERVICES

A "Request for Verification of Taxation Reporting Information" form (Massachusetts Substitute W-9 Format), that contains the Contractor's correct TIN, name and legal address information, must be on file with the Office of the Comptroller. If the Contractor has not previously filed this form with the Comptroller, or if the information contained on a previously filed form has changed, please fill out a W-9 form and return it attached to the executed COMMONWEALTH TERMS AND CONDITIONS FOR HUMAN AND SOCIAL SERVICES.

If the Contractor is responding to a Request for Response (RFR), the COMMONWEALTH TERMS AND CONDITIONS FOR HUMAN AND SOCIAL SERVICES must be submitted with the Response to RFR or as specified in the RFR. Otherwise, Departments or Contractors must timely submit the completed and properly executed COMMONWEALTH TERMS AND CONDITIONS FOR HUMAN AND SOCIAL SERVICES (and the W-9 form if applicable) to the: **Payee and Payments Unit, Office of the Comptroller, 9th Floor, One Ashburton Place, Boston, MA 02108** in order to record the filing of this form on the MMARS Vendor File. Contractors are required to execute and file this form only once.

808 CMR 1.00: COMPLIANCE, REPORTING AND AUDITING FOR HUMAN AND SOCIAL SERVICES

Section

1.01: Purpose, Application, Effective Date, and Authority
1.02: Definitions
1.03: General Provisions
1.04: Recordkeeping and Reporting Requirements
1.05: Non-Reimbursable Costs
1.06: Price Authorization for M.G.L. c. 71B Approved Private School Programs
1.07: Severability

1.01: Purpose, Application, Effective Date, and Authority

(1) Purpose. 808 CMR 1.00 governs contract compliance, financial reporting and auditing requirements applicable to all procurements of Human and Social Services and to M.G.L. c.71B Approved Private Schools subject to the authority of the Division of Purchased Services (DPS). 808 CMR 1.00 also describes the methods used by DPS in authorizing prices for M.G.L. c. 71B Approved Private School special education Programs.

(2) Application. 808 CMR 1.00 applies to Contractors providing Human and Social Services to any Department and to all Contractors operating Programs approved by the Department of Education (DOE) under M.G.L. c. 71B and to their independent auditors, and to any Executive Office, Department, Agency, Board, Commission or Institution of the Executive Department, but excluding the Legislative and Judicial Departments, the Constitutional Offices, the Public Institutions of Higher Education and independent public authorities. Where a Contractor utilizes a subcontractor to provide some or all of the Human and Social Services or in a program approved by DOE under M.G.L. c. 71B, the subcontract between the Contractor and the subcontractor shall require that all provisions of 808 CMR 1.00 shall apply to the subcontractor as well. As 808 CMR 1.00 applies to services purchased pursuant to M.G.L. c. 71B, it also applies to Commonwealth Local Education Authorities (LEAs). DPS shall issue policies, procedures, and forms related to contract compliance, accounting principles, auditing standards, and pricing as may be determined necessary by DPS to implement the provisions of 808 CMR 1.00 and 801 CMR 21.00, which are in addition to the terms of 808 CMR 1.00.

(3) Authority. 808 CMR 1.00 is adopted pursuant to M.G.L. c. 29, § 29B and St. 1993, c. 110, § 274, as amended, and any successor provision thereto.

1.02: Definitions

Unless the context requires otherwise, terms used in 808 CMR 1.00 shall have the following meaning:

Administration and Support Costs. Administration and Support Costs (management and general) include expenditures for the overall direction of the organization, general record keeping, business management, budgeting, general board activities, general legal expenses and related purposes. "Overall direction" includes the salaries and expenses of the chief officer of the organization and the chief officer's staff. If such staff spends a portion of its time directly supervising fundraising or Program service activities, such salaries and expenses are considered indirect fundraising or Program costs and should be prorated (allocated) among those functions by position title or type of expense.

Authorized Price. A price which has been agreed upon in a contract or, in the case of M.G.L. c. 71B Programs, the price authorized by DPS. For health care services (including Title XIX), as defined in M.G.L. c. 118, § 2 (b), the Authorized Price shall be set by the Division of Health Care Finance and Policy or the Division of Medical Assistance.

Base Year. The Fiscal Year which may be designated by DPS for the purpose of its Program pricing activity under 808 CMR 1.06.

Client. An individual, group of individuals, or the family or other person who provides support to such individuals, who is eligible for or receiving Human and Social Services. Also referred to as a consumer.

1.02: continued

Client Resources. Revenue received in cash or in kind from Clients to defray all or a portion of the cost of services. These may include supplemental social security income received by the Contractor to defray the room and board expense of residential Clients. Clients' food stamps, or payments made by Clients according to ability to pay, such as a sliding fee scale.

Commercial Income. The difference between gross revenues and gross expenses resulting from the production of commercial products and services by Clients.

Contractor. An individual or organization which enters into a contract with a Department or the State to provide Human or Social Services or which operates Programs approved by the Department of Education under M.G.L. c. 71B.

Days. Calendar days, unless otherwise specified.

Department. Any Executive Office, Department, Agency, Office, Division, Board, Commission or Institution within the Executive Branch, excluding the Legislative Branch, Judicial Branch, Constitutional Offices, Elected Offices, Public Institutions of Higher Education, the Military Division and Independent Public Authorities. The term also includes Massachusetts Local Education Authorities (LEAs) when purchasing M.G.L. c. 71B Approved Private School Programs.

Department of Education (DOE). The Massachusetts Department of Education established by M.G.L. c. 15, § 1, including its departments and divisions.

Division of Purchased Services (DPS). The office within the Operational Services Division of the Executive Office for Administration and Finance.

Fiscal Year of the Commonwealth. The 12 month period beginning on July 1 and ending on June 30th.

Human and Social Services. Services provided by a Contractor to assist, maintain or improve the personal, mental or physical well-being of Clients. This may include, but is not limited to, social, habilitative, rehabilitative, health, mental health, mental retardation, special education, vocational, employment and training and elder services.

Local Education Authority (LEA). A local school district or public school defined pursuant to M.G.L. c. 71B.

M.G.L. c. 71B Approved Private School. A private day or residential school approved in accordance with DOE regulation 603 CMR 18.00 or successor thereto. Also referred to as Approved Private School.

Maximum Obligation. The maximum dollar amount of the Department's contract to pay for Human and Social Services.

1.02: continued

Off-Setting Revenue. The sum of the following items:

(a) any Contractor funds (including but not limited to public and private grants, gifts, contributions, bequests, or any income therefrom, income from endowments, funds received from the Job Training Partnership Act, the Massachusetts Department of Education's Bureau of Nutrition, or similar funding) to the extent that these sources are restricted to use in the Program and during the year for which a price is developed;

(b) the amount of unrestricted funds voluntarily designated by the Contractor to defray the cost of Program services to a Department;

(c) the fair market value of any public employees assigned to work in the Contractor's Program (including salaries, fringe benefits and travel allowances) and/or the occupancy of public facilities to the extent that they are available to the Program without charge or at less than fair market value;

(d) any funds (including but not limited to Supplemental Social Security Income, Food Stamps, Emergency Aid to the Elderly, Disabled and Children (EAEDC), reimbursements from third-party payers, Client sliding fee scale payments) received by or available to the Contractor during the price year on account of Clients;

(e) the amount of Commercial Income that the Contractor or Department may designate;

(f) the value of funds used to defray non-reimbursable costs; and

(g) not-for-profit Contractor surplus revenue retention funds accrued in excess of the limitations of 808 CMR 1.03(7) which may be utilized at the discretion of the Department to reduce the Authorized Price or Maximum Obligation of the Commonwealth.

Office of Child Care Services (OCCS). An office of the Commonwealth established by M.G.L. c. 28A.

Program. The delivery of one or more discrete services in an organized and coordinated fashion in order to achieve contract objectives or a M.G.L. c. 71B private special education Program approved by DOE.

Reimbursable Operating Costs. Those costs reasonably incurred in providing the services described in the contract and/or, in the case of a Program approved under the provisions of M.G.L. c. 71B, in providing the services mandated by DOE or specifically included in an Authorized Price, with the exception of costs enumerated in 808 CMR 1.05 and costs excluded in the Authorized Price. Operating costs shall be considered "reasonably incurred" only if they are reasonable and allocable using the standards contained in Federal Office of Management and Budget Circular A-122 or A-21, or successors thereto.

Related Party. Any person or organization satisfying the criteria for a Related Party published by the Financial Accounting Standards Board in Statement of Financial Accounting Standards No. 57 (FASB 57).

Restricted Funds. Those temporarily and permanently Restricted Funds, as defined in the Uniform Financial Statements and Independent Auditor's Report (UFR), which have been designated to a specific use by their donor. Funds which have been restricted as to application by the Contractor's governing body are not considered restricted.

Submit or Submission. Unless otherwise provided, to deliver a document by hand or by depositing it with the US Post Office or other delivery service, postage pre-paid.

Uniform Financial Statements and Independent Auditor's Report (UFR). A uniform reporting system, established by DPS, consisting of basic financial statements prepared and audited in accordance with generally accepted accounting principles (GAAP) and generally accepted governmental auditing standards (GAGAS), supplemental schedules and other information as deemed necessary.

1.03: General Provisions

(1) Client Identification. No documents submitted to DPS shall include information that identifies a Client by name or by other means that includes personally identifiable information. Client identification numbers or another numbering scheme should be utilized.

1.03: continued

(2) Waiver of Regulations. Upon request of a Department or Contractor, DPS may consider waiving the applicability of one or more provisions of 808 CMR 1.00, provided that all such requests: are in writing and signed by an authorized signatory; specify the transactions to which such waiver would apply and the specific provisions of 808 CMR 1.00 which are to be waived; and are accompanied by documentation and justification deemed sufficient by DPS to support the need for relief. Waivers do not affect the responsibility of a Department or Contractor to comply with other applicable regulations or statutes.

(3) CMR 1.00 Prohibitions. The failure of a Department or DPS to identify violations of 808 CMR 1.00 in determining or authorizing a price shall not be deemed a waiver of violations of 808 CMR 1.00 which are identified later.

(4) Price Limitations.

(a) No Authorized Price may exceed the lowest fee that is charged to the general public or any third party payer, except when that fee is due to a sliding fee scale based on a Client's ability to pay.

(b) Except as provided in 808 CMR 1.03(4)(a), no Department may pay other than the Authorized Price.

(5) Reimbursement as Full Payment. Each Contractor shall, as a condition of accepting payment made by one or more Departments for services provided, accept the Authorized Price as full payment and discharge of all obligations for the services provided. There shall be no duplication or supplementation of payment from sources other than those expressly recognized or anticipated in the determination of the Authorized Price. Any Client Resources or third party payments made on behalf of a Client, not expressly recognized or anticipated in the computation of the Authorized Price, shall reduce the amount of the appropriate Department's obligation for service rendered to the Client.

(6) Commercial Fee. Departments may prospectively negotiate an earnings allowance with for-profit Contractors, which is in excess of the costs for the services being procured. In cost plus fixed fee contracts, this is also referred to as the fee portion of fee-for-service.

(7) Not-for-Profit Contractor Surplus Revenue Retention. If, through cost savings initiatives implemented consistent with programmatic and contractual obligations, a non-profit Contractor accrues an annual net surplus from the revenues and expenses associated with services provided to Departments which are subject to 808 CMR 1.00, the Contractor may retain, for future use, a portion of that surplus not to exceed 5% of said revenues. The cumulative amount of a Contractor's surplus may not exceed 20% of the prior year's revenues from Departments. Surpluses may be used by the Contractor for any of its established charitable purposes, provided that no portion of the surplus may be used for any non-reimbursable cost set forth in 808 CMR 1.05, the free care prohibition excepted. DPS shall be responsible for determining the amount of surplus that may be retained by each Contractor in any given year and may determine whether any excess surplus shall be used to reduce future prices or be recouped.

1.04: Recordkeeping and Reporting Requirements.

(1) Recordkeeping. The Contractor and its subcontractors shall keep on file all data necessary to satisfy applicable reporting requirements of the Commonwealth (including DPS, the Division of Health Care Finance and Policy and Departments), and financial books, supporting documents, statistical records, and all other records which reflect revenues associated with and costs incurred in or allocated to any program of services rendered under the Contract. The Contractor and its subcontractors shall maintain records of all types of expenses and income or other funds pertaining to the program paid to the Contractor by every source, including from each Client. Books and records shall be maintained in accordance with generally accepted accounting principles as set forth by the American Institute of Certified Public Accountants (AICPA); which for not-for-profit Contractors shall be the Industry Audit Guide for Audits of Voluntary Health and Welfare Organizations, unless otherwise provided in the UFR. In addition, personnel records shall be maintained for each employee in accordance with generally accepted accounting principles recommended by the AICPA and sufficient to meet the requirements of M.G.L. c. 151, the Fair Labor Standards Act of 1938 and contract terms. If the Contractor or a subcontractor receives any federal funds from the Commonwealth, directly or through subcontracts, the Contractor or subcontractor shall also keep data necessary to satisfy Federal Office of Management and Budget (OMB) Circular A-133, or successor provision and shall also maintain books and records in accordance with OMB Circular A-110 and OMB Circular A-122, or successor provisions.

1.04: continued

(2) Annual Audit. Each Contractor shall, on or before the 15th day of the fifth month after the end of its fiscal year, Submit to DPS a UFR or a certification of exemption, in accordance with the standards and instructions contained in the UFR. The UFR and related materials submitted by a Contractor to DPS shall be certified under pains and penalties of perjury as true, correct and accurate by a Massachusetts independent public accountant engaged by the Contractor or by an authorized signatory for the Board of Directors or officers of the corporation, the Executive Director, or Chief Financial Officer of the Contractor.

(3) Other Reporting Requirements. In addition to reports required by contract, secretariats are authorized to develop and implement procedures and reporting requirements for Contractor qualification and risk management purposes.

(4) Related Party Transactions. Notice of all Related Party transactions (including the relationship of the Related Party and a description of the nature and amount of the transaction) shall be made in writing to DPS and the Department(s) prior to their execution. In the case of an M.G.L. c. 71B Approved Private School Program, notification shall be given to DPS and DOE. If disclosure was made through a response to a Request for Response pursuant to 801 CMR 21.00, within an executed contract, or through other formal means, such disclosure will satisfy the requirements of 808 CMR 1.04(4). Prior written disclosure shall not be required where the total value of transactions with a Related Party is less than $100 within the year, and shall not be required where the transaction is a gift to the Contractor from an official, administrator or manager of the Contractor.

(5) Inventory of Equipment and Furnishings. Any Contractor in possession of furnishings and equipment to which a Department has title shall label, maintain and keep on file a written inventory of the property. Said inventory shall contain the sources of funding, description and location of each item, as well as such other information as may be required by the Department. Upon termination of the Contractor's contracts with the Department, the property shall be returned to the Department or transferred to another Contractor, as directed by the Department.

(6) Requests for Additional Information. Each Contractor and Department shall Submit such additional information as DPS may from time to time require, no later than 21 Days after the date of the postmark of a written request.

(7) Extensions. At its discretion, DPS may in exceptional circumstances grant one extension of the filing deadline for Submission of the reporting requirements contained in 808 CMR 1.04(2) or (6). A written request for an extension must be received by DPS prior to the original due date.

(8) Access and Examination of Records. A Contractor shall make available for review, inspection and audit all records relating to its operations and those of its affiliates, subsidiaries and Related Parties to any contracting Department, Executive Office, DPS, the Office of the State Auditor, the federal government or their representatives. Audit of records by DPS or Departments shall be conducted according to the "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions", as published by the United States General Accounting Office.

(9) Field Audits and Quality Control Reviews. DPS may coordinate and conduct field audits of Contractors and quality control reviews of auditor's reports and work papers in the possession of the Contractor or its independent auditor. DPS may photocopy work papers and related documents, as deemed necessary.

(10) Audit Resolution Policy. DPS will maintain an audit resolution policy in accordance with generally accepted government auditing standards. The policy shall describe the circumstances requiring a Contractor to execute a corrective action plan and shall set forth the minimum requirements for an acceptable plan.

(11) Penalties.

(a) Application. DPS, Secretariats and Departments have authority to pursue remedial measures and assess penalties under the provisions of 808 CMR 1.04(11). In addition, DPS or Secretariats may require Departments or the Office of the Comptroller to take action necessary to carry out any penalty assessed by DPS or Secretariats. The availability of penalties under 808 CMR 1.04 shall not limit the Commonwealth's rights to pursue other remedies available by law, regulation, contract or the audit resolution policy.

1.04: continued

(b) Failure to Comply with 808 CMR 1.04(1),(2),(3),(6),(8), (9) or (10). If a Contractor fails to comply with 808 CMR 1.04(1), including correction of deficiencies, 808 CMR 1.04(2), (3), (6), (7), (8), (9) or (10) in a timely manner, regardless of the stated reason, the Contractor may be subject to penalties up to and including: delay of payment, disallowance of payment of expenses relative to which documentation sufficient to meet the governmental agencies' inspection or auditing standards is not provided, restriction on bidding for new contracts, restriction from receiving additional funds or price increases, determination that the Contractor is ineligible for the ready payment system under 815 CMR 3.10(1), or debarment from doing business with the State. In addition, Contractors of special education services shall be deemed ineligible for an increase to prices authorized pursuant to the provisions of 808 CMR 1.06.

(c) Failure to Comply with 808 CMR 1.04(4), 1.04(5) or 1.05(25). If, after a hearing, DPS finds a violation of 808 CMR 1.04(4), 1.04(5) or 1.05(25), DPS may order that the contract(s) directly affected by such violation be terminated or may assess a civil penalty of not more than $2,000 or 10% of the Contractor's annual Maximum Obligation under such contract(s), whichever is greater. If DPS determines after a hearing that a Contractor has committed repeated willful violations of 808 CMR 1.04(4), 1.04(5) or 1.05(25), DPS may debar the Contractor for a period not to exceed five years.

1.05: Non-Reimbursable Costs.

Funds received from Departments may only be used for Reimbursable Operating Costs as defined in 808 CMR 1.02. In addition, funds may not be used for costs specifically identified in 808 CMR 1.05 as non-reimbursable. Expenditures not in accordance with this paragraph are subject to recoupment, intercept, offset, and where appropriate, the Authorized Price is subject to adjustment, as determined by the Commonwealth.

(1) Unreasonable Costs. Any costs not determined to be Reimbursable Operating Costs as defined in 808 CMR 1.02 or any amount paid for goods or services which is greater than either the market price or the amount paid by comparable Departments or other governmental units within or outside of the Commonwealth.

(2) Certain Depreciation.

(a) Depreciation for assets to the extent that the assets have previously been depreciated by the Contractor.

(b) Depreciation which is computed by a method other than the following: an historical cost basis with a straight line method; using a schedule of asset service lives pursuant to DPS policy; and charging one half of the annual depreciation expense in each of the years of acquisition and disposal.

(c) Depreciation on idle, excess, or donated assets or on that portion of an asset's historical cost basis which was paid for from Restricted Funds.

(d) Depreciation on assets acquired under a capital budget approved by a Department and held in trust for the Commonwealth of Massachusetts under the terms of a contract.

(3) Certain Interest.

(a) Any interest paid or accrued upon funds advanced or borrowed from any owner, partner, officer, stockholder, Related Party, or affiliated or parent organization which exceeds the prime rate plus 1% as published in The Wall Street Journal for similar obligations issued at the same time and for the same amount of time.

(b) Any interest paid or accrued to inter-fund borrowing.

(c) Any interest paid or accrued during the reporting year which is not supported by documentation and certification to demonstrate that payment of interest and repayment of principal are required under a definite schedule, or upon demand, pursuant to a written contract.

(d) Any interest or penalties incurred because of late payment of loans or other indebtedness, late filing or payment of federal and state tax returns, municipal taxes, unemployment taxes, social security, and the like.

(e) Any interest paid or accrued upon funds advanced or borrowed to the extent of income received or accrued from the investment of Restricted Funds which were available to defray all or a portion of the expenses to which borrowed or advanced funds were applied.

(4) Current Expensing of Capital Items. All costs attributable to the current expensing of a capital item. A capital item is:

(a) an asset or group of assets which costs more than $500 in aggregate and has a useful life of more than one year; or

1.05: continued

(b) a repair, betterment or improvement or a group of repairs, betterments or improvements which costs more than $500 in aggregate and which adds to the permanent value of an asset or prolongs its useful life for more than one year.

(5) Certain Salaries and Consultant Compensation. Those salaries, wages, and consultant compensation considered to be excessive by DPS, in light of salaries, wages and consultant compensation of other comparable Contractors.

(6) Bad Debts. Those amounts (whether estimated or actual) which represent the portion of an account or note receivable that proves to be entirely uncollectible despite collection efforts including legal action, and any related legal costs.

(7) Taxes. Federal corporate income taxes and the income related portion of the Massachusetts corporate excise tax.

(8) Related Party Transaction Costs. Costs which are associated with a Related Party transaction are reimbursable only to the extent that the costs do not exceed the lower of either the market price or the Related Party's actual costs. Notwithstanding the above provision, when the following conditions are satisfied Related Party transaction costs are reimbursable up to market price:

(a) the transaction is for a good or service which the Related Party sells to the general public;
(b) the Related Party's transactions with the Contractor in the reporting year comprise less than 10% of the Related Party's annual sales of that good or service to the general public (excluding sales to other parties also related to the Related Party under FASB 57); and
(c) the Contractor has approved the transaction by vote of independent directors, or a committee of independent directors, following full disclosure of the Related Party's interests.

Further, costs associated with a Related Party transaction which would not be Reimbursable Operating Costs to a Contractor under 808 CMR 1.02 and 808 CMR 1.05 are non-reimbursable. Transactions with a Related Party totaling less than $100 annually may be reimbursed at market prices.

(9) Certain Fringe Benefits.
(a) Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable Contractors and fringe benefits to the extent that they are not available to all employees under an established policy of the Contractor. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs.
(b) Employer contributions to pension, annuity, and retirement plans which have been denied approval by the Internal Revenue Service.

(10) Fundraising Expense. The cost of activities which have as their primary purpose the raising of capital or obtaining contributions, including the costs associated with financial campaigns, endowment drives, and solicitation of gifts and bequests. However, if a Program does not, or cannot be reasonably expected to, receive federal funds, the fundraising expenses specifically for raising capital or obtaining contributions for Commonwealth funded Programs may be off-set against the revenue generated, except no loss will be reimbursable. To be reimbursable, the Contractor must maintain accounting systems which adequately segregate those fundraising expenses and revenues associated with Commonwealth purchased Programs from other Contractor Programs in accordance with generally accepted accounting principles.

(11) Travel Allowances. Any amount advanced, paid, or accrued to reimburse the Contractor's employees for the use of a private motor vehicle on official agency business in excess of the amount allowed under the United States Internal Revenue Code §§ 61 and 62.

(12) Non-Program Expenses. Expenses of the Contractor which are not directly related to the social service Program purposes of the Contractor.

(13) Security Deposits. Money deposited by the Contractor with a lessor of real property as security for full and faithful performance of the terms of a Contractor's lease.

(14) Free Care. Costs associated with free service and use.

1.05: continued

(15) Research. The costs related to the conduct of grants, contracts, investigations, or Programs directed at the understanding, cause or alleviation of physical, mental or behavioral conditions. All costs of salaries, supplies, equipment, and overhead which are directly related to research are to be excluded. Data gathering and Program analysis are not considered to be research.

(16) Management Agency Fees. Fees charged to the Contractor by a management agency which exceed the costs the Contractor would have incurred had it not entered into a management agreement.

(17) Costs Resulting from a Change of Assets.

(a) Any costs related to a change of Program ownership that has not been recognized by the Commonwealth because of one or more of the following conditions:

1. The transfer of Program ownership occurred between Related Parties;
2. The transfer of Program ownership was not made for reasonable compensation;
3. The transfer of Program ownership was not a genuine transfer of all the powers and rights of ownership;
4. The transfer of Program ownership did not show an intent to sell the assets or the transfer increased the cost basis of either the transferor or transferee; and
5. In the case of a financing agreement between the transferor and the transferee, the agreement was not designed to bring about a complete transfer of Program ownership or there was not compliance with the terms of the agreement.

(b) When a change of Program ownership has been recognized by the Commonwealth, as follows:

1. For land, costs that exceed the lower of the acquisition cost or the basis allowed the immediate prior owner.
2. For furnishings and fixtures and equipment, costs that exceed the lower of the acquisition cost or the basis allowed the immediate prior owner, reduced by the amount of actual depreciation (or principal payments in lieu of depreciation) included as a Reimbursable Operating Cost.
3. For buildings, costs that exceed the lower of the acquisition cost, 100% of the most recent 100% property valuation reduced by the amount of actual depreciation (or principal payments in lieu of depreciation) included as Reimbursable Operating Costs to the immediate prior owner, or an independent appraisal made by a qualified appraiser. Appraisals using the income approach to establish value will not be recognized.

(c) Where there has been an exchange of assets by a Related Party, costs in excess of the cost previously allowed to the Contractor with the Related Party relationship for the exchanged assets.

(d) Where there has been an exchange of assets between Contractors and such exchange results in a sale-lease back, costs in excess of the transferor's allowable costs for the exchanged assets.

(18) Lobbying Costs. Funds used to compensate or reward lobbyists, consultants or staff to promote, oppose, or influence legislation, or influence the governor's approval or veto thereof or to influence the decision of any member of the Executive branch where such decision concerns legislation or the adoption, defeat, or postponement of a standard, rate, rule or regulation pursuant thereto, and any costs associated with lobbying activities. This prohibition shall apply where the lobbyists, consultants or staff, as any part of their regular and usual employment and not simply incidental thereto, attempt to promote, oppose or influence legislation, approval or veto, or regulations, whether or not any compensation in addition to the salary for such employment is received for such services.

(19) Certain Reporting Year Expenditures. Reporting year expenditures in the operating fund for which Restricted Funds were available but not used.

(20) Itemized Deductions. All expenses not qualifying as itemized business deductions under the United States Internal Revenue Code.

(21) Litigation Costs. All costs incurred in connection with the prosecution or defense of claims against the State or any of it subdivisions, including, but not limited to, legal, accounting, and consulting costs. Reasonable expenses of a successful price appeal under 808 CMR 1.06(6) will not be considered non-reimbursable.

(22) Unallowable Costs under OMB Circular A-122 and A-21, or Successor Provisions. Costs which are not allowable under OMB Circular A-122 and A-21, or successor provisions, are non-reimbursable to Programs which receive federal financial assistance.

1.05: continued

(23) Luxury Items. All costs associated with luxury items including, but not limited to luxury passenger automobiles as defined in §§ 4001 or 4002 of the Internal Revenue Service Code, airplanes, boats, vacation homes, alcoholic beverages, charitable contributions and donations, and all non-Program entertainment expenses.

(24) Salaries of Officers and Managers. Salaries of officers and managers to the extent they exceed the rate paid to state managers in job group M-XII, step seven.

(25) Mortgage Principal. Mortgage principal on an amortized or other basis: no Department shall reimburse a Contractor for the principal portion of any note secured by a mortgage on property owned directly or indirectly by the Contractor.

(26) Undocumented Expenses. Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.

(27) Administration and Support Costs. Costs which are otherwise non-reimbursable under the provisions of 808 CMR 1.05 may not be reimbursed through Administration and Support Costs.

1.06: Price Authorization for M.G.L. c. 71B Approved Private School Programs

808 CMR 1.06 sets forth the eligibility and procedural requirements applicable to M.G.L. c. 71B Approved Private School Programs seeking Massachusetts approved prices. 808 CMR 1.06 does not limit the prices a Contractor may charge to other purchasers of a Program, however, pursuant to 808 CMR 1.03(4) no price authorized under 808 CMR 1.06 may exceed the lowest price charged by a Contractor to other purchasers of the Program.

(1) Annual Price Authorization for Approved Private School Programs Located within the Commonwealth.

(a) Eligibility for a Price Increase. In order for it to be eligible for an increase to its currently Authorized Price, an Approved Private School Program must meet each of the following criteria:

1. The Contractor must have filed a UFR or appropriate documentation of exemption for the designated Base Year in accordance with 808 CMR 1.04 or predecessor regulation and the instructions to the UFR, and
2. The Program's Authorized Price must not have been either:
   a. recalculated pursuant to 808 CMR 1.06(4) or predecessor regulation as a result of revision by DOE of the Program's approved staffing and other components since the Base Year, or
   b. authorized pursuant to 808 CMR 1.06(3) or predecessor regulation since the Base Year.

(b) Price Determination for Eligible Programs. If a Program has been determined to be eligible for a price increase, DPS will establish a subsequent year price for the Program by adding a per student annual adjustment amount to the current year Authorized Price. The per student annual adjustment amount will be determined by multiplying the current Authorized Price by a percentage factor, as determined on an annual basis by DPS. Unless otherwise provided in 808 CMR 1.06, this price will be the annual price authorized for the subsequent Fiscal Year.

(c) Price Determination for Other Programs. If a Program does not satisfy the criteria for a price adjustment under 808 CMR 1.06(1)(a), DPS will authorize a price for the Program equal to the current Program price, unless otherwise provided in 808 CMR 1.06.

(d) Additional Price Adjustments.

1. Adjustments to Account for Surplus Revenues and Audit Findings. Where a Contractor has accumulated a surplus in the Base Year in excess of the limitations contained in 808 CMR 1.03(7), or an audit of the Program by the Office of the State Auditor has determined that Program funds are subject to recoupment or DPS has determined that Department funds have been expended by the Program on non-reimbursable costs, DPS may adjust the Program price to recoup such excess surplus or inappropriate expenditures. Such adjustments may reduce the base upon which future years' prices are determined.

1.06: continued

2. Adjustments for Failure to Comply with Audit Requirements. DPS will rescind any price increase authorized under 808 CMR 1.06 and will adjust the Authorized Price accordingly if, by June 1:

a. the Contractor has failed to correct UFR filing deficiencies identified by DPS; or

b. the Contractor has not executed a corrective action plan, in accordance with the DPS Audit Resolution Policy relative to material and reportable internal control and compliance findings contained in its UFR for the Base Year.

(e) Adjustments to Reflect Price Increases Due to Extraordinary Circumstances. The Program price authorized under 808 CMR 1.06(1) may be prospectively adjusted for increases subsequently granted under 808 CMR 1.06(4), however any adjusted price shall not exceed the greater of the price authorized under 808 CMR 1.06(1), or that granted under 808 CMR 1.06(4).

(f) Annual Adjustment Limitation. No price authorized under 808 CMR 1.06(1) except a price authorized under 808 CMR 1.06(1)(e) may exceed the price in effect for the current Fiscal Year plus the annual adjustment percentage determined annually by DPS.

(g) Prices authorized pursuant to 808 CMR 1.06(1) will be authorized on or before the first Wednesday in February of each year and shall become effective on July 1 following authorization.

(2) Annual Price Authorization for M.G.L. c. 71B Approved Private Schools Located Outside the Commonwealth of Massachusetts. Any price authorized pursuant to 808 CMR 1.06(2) shall be effective on the date of authorization by DPS, or the effective date as determined by the state in which the Program is located, whichever is later. Prices authorized by DPS under 808 CMR 1.06(2) shall remain in effect until superseded by DPS.

(a) If an Approved Private School Program is located outside of the Commonwealth of Massachusetts in a state which has an established state rate or price setting mechanism, DPS will authorize as the price to be paid by Commonwealth Departments the price established, authorized or approved by the state in which the Program is located, provided that the price is the lowest charged by the Contractor for the Program. In order for DPS to authorize a price, the following must be submitted to DPS by the Contractor:

1. A UFR or certificate of exemption for the most recent reporting year, in accordance with the UFR instructions;

2. A certification from the Contractor that the price requested to be authorized is the lowest charged by the Contractor for the Program; and

3. A copy of the price authorization or approval by the state in which the Program is located, including the effective dates of the price.

4. If the requested price is not the lowest charged by the Contractor for the Program, the Contractor must identify the amount of the lowest price charged, which will then be authorized by DPS.

(b) If an Approved Private School is located outside the Commonwealth of Massachusetts in a state where there is no established state rate or price setting mechanism, DPS will determine and authorize a Program price pursuant to the provisions of 808 CMR 1.06(1) or (3), as applicable.

(3) Price Authorization For New M.G.L. c. 71B Approved Private School Programs. Upon the request and recommendation of DOE, DPS will review a proposed Program price for a new M.G.L. c. 71B approved Program. DPS may require that information sufficient for its review, including format of the information, be submitted with the DOE request and recommendation. After review, DPS may authorize the proposed price, authorize an adjusted price, or suspend action pending the receipt of additional information. A price authorized under the provisions of 808 CMR 1.06(3) is subject to review and adjustment after six months based on a review and analysis of the Contractor's actual expenditures. Six months after the effective date of the price, or the Program becomes operational, whichever is later, the Contractor must Submit, in UFR format, actual expenditure and revenue reports according to the instructions to the UFR, including an accountant's review report. Within 60 Days of the receipt of the required materials, DPS shall notify the Contractor of any adjustments to be made to the Authorized Price.

(4) Price Adjustment for M.G.L. c. 71B Approved Private School Programs - Extraordinary Relief.

(a) Conditions for Consideration of Extraordinary Relief. Where an Approved Private School experiences additional expenses for its Program during the price year which are necessary for the provision of the mandated program of services and which it cannot absorb within its Authorized Price, the Contractor may apply to DPS for a price adjustment for the Program during the price year if the expenses are necessary to:

1.06: continued

1. meet federal or state statutory, or local regulatory requirements, including DOE or OCCS regulations and licensing requirements not currently included in the Authorized Price, or

2. account for unanticipated emergencies beyond the reasonable control of the Contractor.

(b) To be eligible for consideration for extraordinary relief the conditions described in 808 CMR 1.06(4)(a) must have resulted from unforeseen events occurring after July 1 of the current Fiscal Year.

(c) Required Documentation. To be eligible for consideration for extraordinary relief, the Contractor's request must include the following:

1. a detailed description of the situation which has caused the Contractor to seek extraordinary relief;

2. price year income and expenses to date for the Approved Private School Program(s) for which extraordinary relief is being sought;

3. a copy of the Contractor's most recently completed fiscal year UFR;

4. a copy of the Approved Private School Program budget(s) for the current fiscal year using the components contained in the UFR and instructions thereto;

5. a listing of the Approved Private School Program purchasers for the current Fiscal Year, including the number of students for each purchaser;

6. the average enrollment, by month, of the Approved Private School Program(s) for the most recently completed 12 month period;

7. substantial evidence that the Contractor's resources are insufficient to cover the expenses for which extraordinary relief is sought, including substantial evidence that the Contractor has exhausted all programmatic and financial resources. For the purposes of 808 CMR 1.06(4)(c)(7), "programmatic and financial resources" shall not include unrestricted funds or revenues as defined in the instructions to the UFR which have not been specifically designated for use by the Approved Private School Program by the Contractor, but shall include, and not be limited to, surplus revenues as determined by DPS under 808 CMR 1.03(7).

8. evidence, for each cost for which extraordinary relief is sought, that the Contractor acted prudently, reasonably and in compliance with the law;

9. citations or notices of violations of federal, state or local statute or regulation supporting the request, and a statement from the appropriate authority that it requires the expense or item for which extraordinary relief is being sought;

10. documentation that the current operating expenses are in compliance with the reimbursable cost standards contained in 808 CMR 1.02 and 1.05;

11. the Contractor's requested price;

12. documentation that the Contractor has notified all entities which currently purchase the Approved Private School Program that it has requested extraordinary relief, and the amount of the requested price; and

13. where a Contractor's request includes expenses for additional Approved Private School Program staff, a staff listing, prepared using position titles contained in the instructions to the UFR and containing the number of proposed full time equivalents for each position title. Such a staff listing shall include a statement, signed by an authorized representative of DOE and/or OCCS indicating that the agency's regulation requires the listed staffing level and the number of students the staffing is intended to serve.

(d) Submission. The Contractor shall Submit its request, together with all the required documentation under 808 CMR 1.06(4)(c)(1) through (13) to DPS, with a copy to DOE. A request will be deemed incomplete until all of the required documentation is submitted, and no action will be taken by DPS on an incomplete application. DPS may request additional or clarifying information from the Contractor. Should these requests not be satisfied within 21 Days of the postmark of such request, extraordinary relief shall not be granted.

(e) Adjusted Price. DPS will take action on a complete request within 60 Days of the receipt of materials required under 808 CMR 1.06(4)(d). Should DPS determine that the Contractor's request meets the requirements of 808 CMR 1.06(4)(a), (b) and (c) and that extraordinary relief should be granted, DPS will develop and authorize a price subject to the following conditions:

1. any requested expenses which do not qualify under 808 CMR 1.06(4)(a)(1) or (2) will not be included;

2. any requested expenses which are deemed to be non-reimbursable by DPS using the criteria contained in 808 CMR 1.05 will not be included;

3. any requested adjustments to administrative expenses will not be included;

1.06: continued

4. the additional amount included in any adjusted price for any given item will not exceed the amount of the difference between the Contractor's expense for the item in the most recently completed Fiscal Year, and the current year's anticipated expense, on a per student basis; and

5. no adjusted price will be effective prior to the date of authorization, and no price shall include expenses incurred prior to the date of authorization.

(5) Administrative Review.

(a) DPS may conduct a review of Approved Private School Programs and/or Authorized Prices for good cause, including but not limited to the following reasons: failure to incur costs for items included in the initial price authorization process or later adjustments, failure to provide the approved or required Program services, failure to implement approved or required programmatic or non-programmatic changes included in the price year Reimbursable Operating Costs, or use of Department funds on non-reimbursable costs as defined in 808 CMR 1.05, as determined by DPS.

(b) DPS shall initiate administrative review by notifying the Contractor that it intends to conduct an administrative review and the reason(s) for the review. DPS may require the Contractor and/or Department(s) to Submit books, records and other information it deems necessary for its review. Such requests shall be in writing, and requested materials shall be submitted to DPS within 21 Days of the request.

(c) DPS shall notify the Contractor and the Department(s) of the results of the administrative review. The review may result in an amendment to an Authorized Price.

(6) Contractor Right to Appeal.

(a) Any Contractor aggrieved by the action of DPS relative to action taken under 808 CMR 1.06(1), (2), (3), (4) or (5), who desires a review thereof, may file an appeal with the Division of Administrative Law Appeals within 30 Days of notice of DPS's action. The question on appeal shall be whether DPS, in taking the challenged action, has properly applied its regulations.

(b) The pendency of an appeal under 808 CMR 1.06(6) does not limit DPS's right to undertake an administrative review of any Authorized Price or to take any other corrective action.

(7) Price Authorization in Special Cases.

(a) Individual Prices. DPS will develop, issue, and amend, as necessary, instructions for the authorization of individual prices for services to students enrolled in Approved Private School Programs when that student has a need for additional or unique services which are not provided by the Approved Private School Program.

(b) Specialized Placement Price Authorization. DPS will develop, issue and amend, as necessary, instructions for the development and authorization of prices for individual students who are placed, after approval by DOE pursuant to 603 CMR 28.500 or successor provisions thereto, by a Department in a private school which has not been approved under M.G.L. c. 71B. These placements are also referred to as "sole source" placements.

(c) Special Circumstances. With the consent of DOE and the Contractor, DPS may authorize a price determined in any manner consistent with St. 1993, c. 110, § 274, as amended, should DPS determine that price determination methods under 808 CMR 1.06 are inapplicable to the private school or produce a result which is inconsistent with St. 1993, c. 110, § 274, as amended.

1.07: Severability

The provisions of 808 CMR 1.00 are severable. If any provision of 808 CMR 1.00 or its application is held to be illegal, unenforceable or void, Departments and Contractors shall be relieved of the obligations under that provision and all other provisions shall remain in full force and effect. Such invalidity shall not be construed to affect the application of the provision under circumstances other than those held invalid.

REGULATORY AUTHORITY

808 CMR 1.00: M.G.L. c. 29, § 29B; St. 1993 c. 110, § 274, as amended by St. 1993, c. 151, § 113, St. 1993, c. 296, § 3 and St. 1993, c. 495, § 99.

801 CMR 21.00: PROCUREMENT OF COMMODITIES OR SERVICES, INCLUDING HUMAN AND SOCIAL SERVICES

Section

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21.01: Purpose, Application and Authority

(1) Purpose. The purpose of 801 CMR 21.00 is to provide all Departments with uniform rules and standards governing the Procurement of Commodities or Services, or both, including Human and Social Services for Clients. Procurements will be considered in the best interests, or the Best Value, to a Department and the State when a Procurement supports and balances the following Procurement Principles: the achievement of required outcomes, generates the best quality economic value, is performed timely, minimizes the burden on administrative resources, expedites simple or routine purchases, allows flexibility in developing alternative Procurement and business relationships, encourages competition, encourages the continuing participation of quality Contractors and supports State and Department Procurement planning and implementation.

(2) Application. Unless otherwise provided by law, 801 CMR 21.00 shall apply to all Procurements of Commodities or Services, or both, by any Executive Office, Department, Agency, Office, Division, Board, Commission or Institution within the Executive Branch. 801 CMR 21.00 will not apply to the Legislative Branch, Judicial Branch, Constitutional Offices, Elected Offices, Public Institutions of Higher Education, the Military Division and Independent Public Authorities, although the use of 801 CMR 21.00 by these entities is encouraged. 801 CMR 21.00 will not apply to interdepartmental services or transactions between two or more State Departments (815 CMR 6.00) or to grants and subsidies (815 CMR 2.00). The Executive Office for Administration and Finance (ANF) or the Operational Services Division (OSD) will interpret 801 CMR 21.00 and may take whatever actions necessary to carry out the purposes of 801 CMR 21.00. No Department shall incur any obligation for, or authorize payments for, any Commodities or Services except in accordance with 801 CMR 21.00. ANF, OSD and the Office of the Comptroller (CTR) may issue additional policies, procedures and Contract forms to be used by Departments to carry out the purposes of 801 CMR 21.00. OSD, through its Division of Purchased Services, may issue policies, procedures and Contract forms to be used by Departments for the procurement of Human and Social Services for Clients.

(3) Authority. 801 CMR 21.00 is promulgated under the authority of M.G.L. c. 7, §§ 4, 4A, 22 and 22G-22M; M.G.L. c. 29, §§ 27B, 29A and 29B; St. 1993, c. 110, § 274, as amended; and Executive Orders 279 and 350.

21.02: Definitions

Acquisition Method. The method of procuring a Commodity or Service, or both. Acquisition methods include outright purchase, license, lease-purchase, lease, rental, fee-for-service or other methods authorized by law and implemented in accordance with policies and procedures issued by ANF, OSD and CTR.

Authorized Signatory. An individual authorized in writing to execute Contracts or other agreements or commitments on behalf of a Department or Contractor.

21.02: continued

Available Funding. Operating appropriations, capital appropriations, trust funds or federal grant funds which have been appropriated or authorized for the purposes of a Contract.

Best Value. The result of common sense Procurement decision-making consistent with the States Procurement Principles, which are to balance and support the achievement of: required outcomes, best quality economic value, timely performance, minimizing the burdens on administrative resources, expediting simple or routine purchases, flexibility in developing alternative Procurement and business relationships, encouraging competition, encouraging the continuing participation of quality Contractors and supporting State and Department Procurement planning and implementation.

Bidder. An individual or organization proposing to enter into a Contract to provide a Commodity or Service, or both, to or for a Department or the State.

Client. An individual, group of individuals, the family or other person(s) who provides support to such individuals and who is eligible for or receiving Human and Social Services. Also referred to as "consumer".

Commodities. An article of trade, goods, products, supplies or information technology resources, including automated data processing and telecommunications hardware, software and systems.

Commonwealth Terms and Conditions. Documents, jointly issued by ANF, OSD and CTR, that must be executed by all Contractors that enter into Contracts with the State.

Consultant Contract. A Contract for consultant services pursuant to M.G.L. c. 29, § 29A.

Contract. A legally enforceable agreement between a Contractor and a Department. ANF, OSD and CTR shall jointly issue Commonwealth Terms and Conditions, a Standard Contract Form and other forms or documentation that Departments shall use to document the Procurement of Commodities or Services, or both.

Contract Employee. An individual Contractor whose Contract performance was classified, prior to the Contractor's selection, as work to be performed under the direct supervision and control of the Department, and not work as an independent Contractor, pursuant to the federal Internal Revenue Service (IRS) SS-8 process.

Contractor. An individual or organization which enters into a Contract with a Department or the State to provide Commodities or Services, or both.

Department. Any Executive Office, Department, Agency, Office, Division, Board, Commission or Institution within the Executive Branch excluding the Legislative Branch, Judicial Branch, Constitutional Offices, Elected Offices, Public Institutions of Higher Education, the Military Division and Independent Public Authorities.

Designee. A State employee who has been delegated authority in writing to act on behalf of a Department Head or other Department officer in their official capacity.

Duration. The authorized total period of performance of a Contract under 801 CMR 21.00, which includes the initial duration of a Contract, either less than one fiscal year, a single fiscal year or multiple fiscal years, and any options to renew beyond the initial duration of the Contract.

Environmentally Preferable Products and Services. Commodities or Services that are less detrimental to the environment and human health than competing Commodities or Services serving the same purpose. Includes Commodities or Services that minimize waste, use recycled materials, conserve energy or water, or reduce the consumption or disposal of toxic materials.

21.02: continued

Execution. The distinct, verifiable signature or symbol of an authorized signatory of a Contractor or a Department which, when affixed to a document, is legally binding. If the signature is affixed through electronic means, the action of signing must be accomplished consistent with information processing standards established by CTR or by law.

Executive Office for Administration and Finance (ANF). The Executive Office established by M.G.L. c. 7.

Human and Social Services. Services provided by a Contractor to assist, maintain or improve the personal, mental or physical well-being of Clients. This may include, but is not limited to, social, habilitative, rehabilitative, mental health, mental retardation, special education, vocational, employment and training and elder services.

Independent Contractor. An individual or organization under Contract with a Department where the Contractor's work is not performed under the direct supervision and control of a Department.

Office of the Comptroller (CTR). The Department established pursuant to M.G.L. c. 7A.

Operational Services Division (OSD). The Department within the Executive Office for Administration and Finance established pursuant to M.G.L. c. 7, § 4A to regulate and oversee the Procurement of Commodities or Services in the State. OSD includes the Division of Purchased Services established by St. 1993, c. 110, § 274, as amended.

Procurement. The acquisition of Commodities or Services, or both, which may be made through an outright purchase, license, lease-purchase, lease, rental, fee-for-service or other method approved by OSD or authorized by law.

Procuring Department. A Department authorized to procure Commodities or Services, or both, for the Department or on behalf of multiple Departments. OSD shall be the primary Procuring Department for Statewide Contracts and may designate another Department to act as the Procuring Department for a Statewide Contract.

Recycled Products. Goods containing materials which have been diverted from the solid waste stream including post-consumer materials and materials or by-products generated in industrial processes or which have been wholly or partially remanufactured.

Request for Response (RFR). The mechanism used to communicate Procurement specifications and to request Responses or interest from potential Bidders. An RFR may also be referred to as a "solicitation".

Response. A Response from a Bidder to a Request for Response (RFR) under a competitive Procurement. A Response shall include submissions commonly referred to as "bids", "quotes" or "proposals".

Secretariat. Any Executive Office established by M.G.L. chs. 6A and 7, including any Department, Agency, Office, Division, Board, Commission or Institution within such Executive Offices.

Selected Bidder. A Bidder that has been selected to negotiate a Contract with a Procuring Department.

Services. The furnishing of time, labor, effort or specialized skills by a Contractor. Services shall include operational, professional, maintenance and repair, non-professional, consultant and Human and Social Services, as well as any other services identified in policies and procedures issued by ANF, OSD and CTR.

Standard Contract Form. A Contract form, jointly issued by ANF, OSD and CTR, that Departments shall use for the Procurement of Commodities or Services, or both, which incorporates by reference a Commonwealth Terms and Conditions.

21.02: continued

State. The Commonwealth of Massachusetts.

Statewide Contract. A Contract procured on behalf of all Departments for specified Commodities or Services, or both, which may be used by any Department or other entities authorized by OSD.

Suspension. The halt of Contract performance due to the lack of Available Funding, a breach of Contract, inadequate performance, an unanticipated emergency or other circumstances determined by a Department to warrant a pause in Contract performance. A suspension may continue until lifted by the Department, if the reason for the suspension has been alleviated, or Contract performance may be terminated.

21.03: Requests for Information or Interest (RFI)

A Procuring Department may gather information to assist in the development of a potential Procurement by inviting other Departments, potential Bidders or other interested parties to provide technical and business advice concerning industry standards, practice, general cost or price structures or other information which is relevant to the type of Commodities or Services, or both, that a Procuring Department seeks to procure.

21.04: Statewide Contracts

OSD shall be the primary Procuring Department for Statewide Contracts unless OSD designates another Department to act as the Procuring Department for a Statewide Contract. OSD shall establish Statewide Contracts for Commodities or Services, or both, which shall be available to Departments and other entities authorized by OSD. Departments shall acquire Commodities or Services, or both, from available Statewide Contracts in accordance with policies and procedures issued by ANF, OSD and CTR.

21.05: Competitive Procurement Exceptions

A Procuring Department shall be authorized to procure Commodities or Services, or both, without a competitive Procurement under the following exceptions, and in accordance with policies and procedures issued by ANF, OSD and CTR. Any questions as to the existence of an exception under 801 CMR 21.05 shall be determined by ANF or OSD. All other provisions of 801 CMR 21.00 shall apply.

(1) Incidental Purchases. A one-time purchase, or multiple purchases, with a total dollar value that does not exceed the minimum amount established by law, ANF or OSD.

(2) Exemption from Competitive Procurement. A general law, special law or other existing legal obligation that specifically exempts or prohibits a Procuring Department or a specific Contract from being competitively procured or specifically names a particular Contractor(s) to be awarded a Contract.

(3) Emergency Contract. An emergency Contract shall be appropriate whenever a Procuring Department Head determines that an unforeseen crisis or incident has arisen which requires or mandates the immediate acquisition of Commodities or Services, or both, to avoid substantial harm to the functioning of government or the provision of necessary or mandated services or whenever the health, welfare or safety of Clients or other persons or serious damage to property is threatened. The Contract shall be effective only for the period necessary to cure the emergency or in accordance with policies and procedures issued by ANF, OSD and CTR. Each Secretariat may establish a policy for administering emergency Contracts.

(4) Collective Purchasing. The acquisition of Commodities or Services, or both, by one or more Departments from existing Contracts that have been established by or are proposed by federal agencies, other States or any other public entity. Prior to any acquisitions by Departments under 801 CMR 21.05(4), OSD shall confirm or identify which Contracts may be used by Departments and any other requirements for these Contracts.

21.05: continued

(5) Interim Contracts. An Interim Contract may be used to prevent a lapse of Contract performance in the following circumstances:

(a) Termination or Suspension of Current Contractor. An Interim Contract may be executed whenever an existing Contract has been or will be terminated or suspended for any reason or whenever a Contractor is unable to complete full performance under a Contract. An Interim Contract may be offered to the Bidder that offered the next Best Value Response under the original Procurement and under the same terms and prices offered in that Bidder's original Response. The duration of an Interim Contract shall be limited to the remaining time available under the duration stated in the original RFR, including any options to renew. If the Department is unable to negotiate a Contract with any of the original Bidders who submitted Responses, in their original rank order according to Best Value, and under the same terms as offered in their original Response, the Department will be required to conduct a new competitive Procurement.

(b) Delayed Competitive Procurement. An Interim Contract may be executed with a current Contractor(s) when a new competitive Procurement has been commenced, but due to an unanticipated delay, has not been completed prior to the end of the duration available under the current Contract, as specified in that Contract's original RFR. An Interim Contract may be used to extend the current Contract(s), under the same terms and conditions, only for the period necessary to complete the competitive Procurement, including the execution of new Contracts.

(6) Contract Employees. A Department requiring the performance of an Individual Contractor, where the planned Contract performance has been classified, prior to the Contractor's selection, as work of a Contract Employee and not that of an Independent Contractor, may select an individual for that Contract using a recruitment process similar to the process the Department uses to select employees, rather than using the Request for Response process under 801 CMR 21.06.

21.06: Competitive Procurement Standards

All acquisitions of Commodities or Services, or both, must be competitively procured unless the acquisition qualifies as an exception under 801 CMR 21.05. A Procuring Department shall be responsible for conducting a Procurement for single or multiple Contracts for Commodities or Services, or both, in accordance with 801 CMR 21.00 and policies and procedures issued by ANF, OSD and CTR. The policies and procedures shall address, but shall not be limited to, the following Procurement standards:

(1) Procurement File. A Procuring Department shall maintain a paper or electronic Procurement file for each Procurement of Commodities or Services, or both. The file shall contain the original, copies or the file location of the RFR and data or other information relevant to the Procurement and selection of a Contractor, the executed Contract form(s), correspondence with the Contractor and any applicable approvals or justifications.

(2) Duration. The duration of any Contract procured or executed under 801 CMR 21.00 shall include the initial duration of a Contract, either less than one fiscal year, a single fiscal year or multiple fiscal years, and any options to renew beyond the initial duration of the Contract. The duration established for a Contract shall be the period determined by the Procuring Department to be reasonably necessary to obtain the required Commodities or Services, or both, at the Best Value for the Procuring Department and the State and shall be subject to Available Funding for the Contract, as follows:

(a) The duration of any Contract funded with an annual operating appropriation (account type 01) account(s) is subject to the appropriation by the Legislature, in each fiscal year of the Contract, of sufficient funds for the purposes of the Contract.

(b) The duration of any Contract funded with an annual retained revenue appropriation (account type 01) account(s) is subject to the appropriation by the Legislature, in each fiscal year of the Contract, and receipt of sufficient revenues for the purposes of the Contract.

(c) The duration of any Contract funded with a trust account(s) (account type 03) is subject to the availability, or anticipated availability through authorized revenues, of sufficient funds for the purposes of the Contract. Payments are contingent upon the receipt of sufficient trust revenues to support payments under the Contract.

(d)

21.06: continued

(d) The duration of any Contract funded with a federal grant appropriation (account type 04) account(s) is subject to approval by the federal government and appropriation by the Legislature, in each fiscal year of the Contract, of sufficient funds for the purposes of the Contract.

(e) The initial duration of any Contract funded with a capital appropriation (account type 02) account(s) is limited to the fiscal years in which sufficient funds are appropriated by the Legislature for the purposes of the Contract, provided that any options to renew which extend beyond the original authorization of funding of the capital account(s) funding the Contract is subject to the extension, by the Legislature, of the authorization of funding or a separate appropriation, in each additional fiscal year of the Contract, with sufficient funds for the purposes of the Contract.

(f) If the appropriation, authorization or Available Funding ceases for a Contract, for any reason, a Contract shall be deemed under Suspension and Contract performance must halt. A Contractor shall not be entitled to compensation for any performance provided during the period of Contract Suspension. A Department may lift the Suspension if Available Funding is received. In the absence of foreseeable Available Funding, a Department may terminate the Contract.

(3) Scope of Contract Participants. A Procuring Department may draft a Request for Response (RFR) for specified Commodities or Services, or both, to include an option for additional Departments to purchase under the same terms of the RFR and may require Bidders to provide Responses specifying their ability to provide the specified Commodities or Services, or both, to other Departments in addition to the Procuring Department and the rates that will be used for the additional business given to the Contractor.

(4) Request for Responses (RFR).

(a) An RFR shall be used to solicit and select Responses from qualified Bidders under a competitive Procurement. The goal of all RFRs shall be to obtain the Best Value of Commodities or Services, or both, for the State. An RFR may include attributes of any of the methods of competitive Procurement formerly referred to as a request for proposals, request for qualifications or quotes, invitation for bids or good business practices.

(b) The Procuring Department shall draft an RFR which it deems appropriate, efficient and cost effective for the type of Procurement required, in accordance with policies and procedures issued by ANF, OSD and CTR. These policies and procedures may include total Contract value thresholds, minimum Procurement requirements and legal or regulatory restrictions, including limitations on the purchasing of certain types of restricted Commodities or Services or from certain restricted Bidders, and requirements and allowable preferences for purchasing of certain types of Commodities and Services.

(c) An RFR shall include the Acquisition Method to be used; whether single or multiple Contractors are sought; whether additional Departments will have access to the Procurement as outlined in 801 CMR 21.06(3); the anticipated duration of the Contract including anticipated renewal options; the available funding or anticipated compensation for the Contract, if relevant; detailed specifications or the anticipated goals or outcomes to be accomplished by the Procurement; instructions for submission of Responses; and a deadline date for submission of Responses.

(d) RFRs may be used to establish criteria which prospective Bidders must satisfy in order to be placed on a list of qualified Contractors. These criteria may include, but are not limited to, technical expertise, experience, quality of performance, location, availability of Commodities and Services, rates, prices, catalogs of Commodities or Services, or both, or other criteria relevant to a particular Procurement.

(e)

21.06: continued

(e) Recycled and Environmentally Preferable Products and Services. OSD, in cooperation with relevant environmental departments, shall periodically establish policies and procedures that promote, to the greatest extent feasible, the statewide procurement and use of recycled products and environmentally preferable products and services (EPPs), and the reporting thereof, by Procuring Departments and Contactors. These policies and procedures shall include, but not be limited to, designating EPPs and establishing minimum standards specifications for their procurement and use. RFRs may provide for additional points for any RFR Response in which a Bidder offers to provide EPPs as part of Contract performance, and for any RFR Reponse in which a Bidder offers to utilize EPPs or implement environmentally preferable practices as part of the performance of its business.

(f) Any Response to an RFR submitted by a Bidder shall be considered a firm offer and shall remain effective unconditionally for a minimum of 90 days unless a longer period is specified in an RFR, or unless extended by the Department upon prior notice to Bidders.

(5) Identification of Bidders or Public Notice. A Procuring Department shall be responsible for identifying Bidders capable and willing to provide the Procuring Department and the State with the Best Value of Commodities or Services, or both. A Procuring Department shall identify potential Bidders through public notice, newspaper or electronic advertisements or other methods identified by ANF or OSD as appropriate for a particular Procurement, or as required by law.

(6) Procurement Amendments. A Procuring Department may, at any time prior to the execution of a Contract, and without penalty, amend a Procurement or change the Procurement requirements, scope, budget or Procurement schedule upon notice to Bidders.

(7) Procurement Cancellation. A Procuring Department may for any reason, and at any time prior to the execution of a Contract, and without penalty, notify Bidders of a cancellation of a Procurement and the rejection of all Responses.

(8) Corrections or Clarifications to a Submitted Response. A Procuring Department shall determine whether to allow a correction of minor informalities in a Response. Minor informalities are matters of form rather than substance and include clerical errors or minimal or insignificant mistakes that can be corrected without prejudice to other Bidders. A Procuring Department may, upon written request of a Bidder, allow a correction of a minor informality in a Response which is clearly evident, such as a typographical error, transposition error or arithmetical error where the correct answer is obvious, or if the mistake is discovered by the Procuring Department, the Procuring Department may note the correction on the Response. If a Procuring Department requires a clarification of any particular section of a Response the Department must provide all Bidders that submitted Responses with the same notice and opportunity for clarification of the identified section in the Response. Clarifications are explanations of what is stated in a Response and may not be used as an opportunity to submit supplemental information or a change to a Response, unless the Department specifically requests these submissions or changes as part of the clarification of all Responses. No correction or clarification of Response prices, terms and conditions or the submission of supplemental information prejudicial to the interests of other Bidders or to fair competition shall be permitted.

(9) References. A Procuring Department shall have the right to request references at any time during the Procurement process and at any time during the period of Contract performance. A Procuring Department may verify any references included in a Bidder's Response and conduct any other reference or credit checks as the Procuring Department deems appropriate. The Procuring Department may consider any written references, including documentation of performance records of a Bidder on file at the Procuring Department or solicited from any other Department or entity, documentation of reference checks or other documentation solicited by or submitted to the Procuring Department during the Procurement process.

21.06: continued

(10) Disqualification. A Procuring Department shall disqualify any Response that the Department determines to be unresponsive, including, but not limited to:

(a) Responses which are received after the deadline for submission specified in an RFR.

(b) Responses that fail to meet, address or comply with material requirements in an RFR, including instructions for submission, content or format.

(c) Responses which indicate collusion or unfair trade practices by one or more Bidders agreeing to act in a manner intended to avoid or frustrate any of the provisions of 801 CMR 21.00 or any other law or regulation.

(d) Responses submitted by a Bidder, or which identify a subcontractor, currently subject to any State or federal debarment order or determination. If the identified subcontractor is replaceable without a material effect on the Bidder's Response, the Bidder may be given the opportunity to select another subcontractor prior to execution of the Contract.

(11) Best and Final Offer, Evaluation of Responses and Selection of Bidder(s). The following options shall be available to a Department even if these options have not been included as part of an RFR:

(a) Best and Final Offer. At any time after submission of Responses and prior to the final selection of Bidders for Contract negotiation or execution, a Procuring Department shall have the option to provide Bidders with an opportunity to provide a Best and Final Offer and may limit the number of Bidders selected for this option.

(b) Evaluation of Responses and Selection of Bidder(s). A Department shall have the authority to evaluate Reponses and select a Bidder(s) that it determines has offered the Best Value Response to the goals and performance requirements outlined in the RFR.

(12) Notification of Selected Bidders. A Procuring Department shall determine the timing and method of notifying Bidders of the Bidder(s) selected for Contract negotiation or the Contractor(s) that has executed a Contract. Notice may be limited to those Bidders who submitted Responses to an RFR.

(13) Press Conferences or News Release Restrictions. No Bidder shall make any press conference, news releases or announcements concerning its selection or non-selection for a Contract prior to the Procuring Department's public release of said information or prior to the written approval of the Procuring Department.

(14) Debriefing. An RFR may contain the opportunity for non-successful Bidders to request a debriefing to be conducted after Contract execution with Selected Bidder(s). Debriefings are designed to identify the weak areas of a Bidder's Response and suggest improvements for future Procurements. Comparisons with other Responses will not be made during a debriefing. If an RFR is silent as to an opportunity for a debriefing, the Procuring Department shall have the option to grant or deny a debriefing and may limit the number of debriefings granted.

(15) Dispute Resolution Procedures for Human and Social Service Procurements. OSD may issue policies and procedures for conducting debriefings and appeals for Human and Social Service Procurements.

(16) Decisions made pursuant to the provisions of 801 CMR 21.00 are not subject to the provisions of M.G.L. c. 30A, §§ 10 and 11.

21.07: Contract Negotiation, Execution and Effective Start Date

(1) Contract and Contract Amendment Negotiation. The Department may negotiate with Selected Bidder(s) prior to execution of a Contract, and with Contractors after a Contract has been executed, as follows:

(a) The language of the RFR shall determine what elements of Contract performance or cost, within the scope of the original RFR and a Bidder's or Contractor's Response, may be negotiated. If the RFR is silent as to what can be negotiated, the Procuring Department and a Selected Bidder or Contractor may negotiate only the details of performance identified within the scope of the original RFR and the Bidder's or Contractor's Response, and may not increase or change the scope of performance or costs.

(b)

21.07: continued

(b) The Department and a Selected Bidder or Contractor may negotiate additional language which clarifies their understanding of, but does not change, the language of the Contract or Contract performance identified within the scope of the original RFR and the Bidder's or Contractor's Response.

(c) Notwithstanding 801 CMR 21.07(1)(a), the Department and a Selected Bidder or Contractor may negotiate a change in any element of Contract performance or cost, identified in the original RFR or the Bidder's or Contractor's Response, which results in lower costs or in a more cost effective or better value than was presented in the Bidder's or Contractor's originally selected Best Value Response.

(2) Contract Execution.

(a) The identification of a Selected Bidder(s) shall create no contractual obligation on the Procuring Department or the State. Performance may not begin, until a Contract is properly executed. The execution of a Contract is conditioned upon the Procuring Department's acceptance of a Selected Bidder's Response excluding any clauses or sections that are stricken by the Department as unacceptable and including any additional negotiated language as authorized under 801 CMR 21.07(1).

(b) Commonwealth Terms and Conditions. An authorized signatory of a Bidder must execute a Commonwealth Terms and Conditions, which is executed only once and must be filed as prescribed by CTR. A Commonwealth Terms and Conditions will be incorporated by reference into and shall apply to any Contract for Commodities or Services, or both, that is executed by the Bidder and any Department of the State.

(c) Standard Contract Form. An authorized signatory of the Contractor and the Department must execute a Standard Contract Form for Procurements under 801 CMR 21.00 in accordance with policies and procedures issued by ANF, OSD and CTR. The Contract shall incorporate by reference a Commonwealth Terms and Conditions and will include the RFR, the Bidder=s Response, excluding any clauses or sections that are stricken by the Department as unacceptable and including any additional negotiated language as authorized under 801 CMR 21.07(1). Contracts must be filed as prescribed by CTR.

(d) A Selected Bidder's Response shall be disqualified if the Procuring Department determines that the Bidder:

1. is intentionally or unreasonably delaying the timely execution of a Commonwealth Terms and Conditions or the Standard Contract Form or is unable to execute timely even for reasonable delays;
2. conditions execution of a Commonwealth Terms and Conditions or the Standard Contract Form upon the Procuring Department's acceptance of additional material or amended Contract terms and conditions, or specifies that the Bidder's Response is "non-negotiable", "all-or-nothing" or that there can be "no substitutions";
3. negotiates in bad faith;
4. refuses to execute a Commonwealth Terms and Conditions or the Standard Contract Form;
5. demands that the Department execute the Bidder's Contract form instead of a Commonwealth Terms and Conditions or the Standard Contract Form; or
6. is unable to reach final agreement on contractual terms with the Department within a reasonable time as determined by the Department.

(e) If a Selected Bidder's Response is disqualified, for any reason, the Procuring Department may negotiate a Contract with the next Best Value qualified Bidder(s).

(3) Contract Effective Start Date. Notwithstanding verbal representations by the parties, or an earlier start date listed in the Standard Contract Form, the effective start date of a Contract shall be the latest of the following dates:

(a) the date the Standard Contract Form has been executed by an Authorized Signatory of the Contractor;

(b) the date the Standard Contract Form has been executed by an Authorized Signatory of the Procuring Department;

(c) the date of Secretariat or other approval(s) required by law or regulation; or

(d) a later date specified in the Standard Contract Form.

21.08: Contract Funding and Compensation

(1) The Contractor shall only be compensated for performance delivered to and accepted by the Department in accordance with the specific terms and conditions of a properly executed Contract. All Contract payments are subject to Available Funding, as described in 801 CMR 21.06(2), and shall be subject to automated intercept pursuant to M.G.L. c. 7A, § 3 and 815 CMR 9.00. Contract payments for Human and Social Services are also subject to the provisions of 808 CMR 1.00. A Department shall be under no legal obligation to compensate a Contractor, or to obtain additional funding for any performance, costs or other commitments which are made outside of the scope of a Contract.

(2) Emergency and Exceptional Circumstances. Notwithstanding 801 CMR 21.07(2)(a) and (3) and 801 CMR 21.08(1), compensation for performance commenced prior to the contract effective start date shall be allowable in unanticipated, rare emergency or exceptional circumstances for the period from the date of the occurrence of such circumstance until a Contract is executed, which shall be documented by the Department as part of the Procurement File in accordance with policies and procedures issued by ANF, OSD and CTR.

(3) Payments cannot be issued until a properly executed Contract, with all requisite approvals, has been filed as prescribed by the CTR.

(4) Notwithstanding 801 CMR 21.07(2)(a) and (3) and 801 CMR 21.08(1), for Human and Social Service Contracts, compensation for performance commenced prior to the Contract effective start date may be made from the later of the following dates, the date of Secretariat or other required approvals, if applicable, or a later date specified in the Standard Contract Form, until a Contract has been executed. 801 CMR 21.08(4) shall be effective until September 30, 1998.

21.09: Quality Assurance

ANF, OSD, and CTR shall establish policies and procedures for conducting reviews of Department compliance with 801 CMR 21.00 and quality of Contractor performance.

21.09: Integration

801 CMR 21.00 shall be interpreted consistent with, and Procuring Departments shall comply with, state or federal general or special laws, regulations, executive orders and other authorities mandating additional requirements related to the procurement of Commodities and Services, including policies and procedures issued by ANF, OSD and CTR.

21.09: Severability

If any provision of 801 CMR 21.00 is declared or found to be illegal, unenforceable or void, then Departments, Bidders and Contractors shall be relieved of all obligations under that provision only, and all other provisions of 801 CMR 21.00 shall remain in full force and effect.

REGULATORY AUTHORITY

801 CMR 21.00: M.G.L. c. 7, §§ 4, 4A, 22 and 22G-22M; c. 29, §§ 27B, 29A and 29B; St. 1993, c. 110 § 274, as amended and Executive Orders 279 and 350.

¶1109 Office of Management and Budget Circular A-122 (8/29/97)

OFFICE OF MANAGEMENT AND BUDGET (OMB)

Circular A-122, "Cost Principles for Nonprofit Organizations"

May 14, 1997 (Recompilation)

To the Heads of Executive Departments and Establishments

Subject: Cost principles for non-profit organizations

1. *Purpose.* This Circular establishes principles for determining costs of grants, contracts and other agreements with non-profit organizations. It does not apply to colleges and universities which are covered by Office of Management and Budget (OMB) Circular A-21, "Cost Principles for Educational Institutions"; State, local, and federally-recognized Indian tribal governments which are covered by OMB Circular A-87, "Cost Principles for State and Local Governments"; or hospitals. The principles are designed to provide that the Federal Government bear its fair share of costs except where restricted or prohibited by law. The principles do not attempt to prescribe the extent of cost sharing or matching on grants, contracts, or other agreements. However, such cost sharing or matching shall not be accomplished through arbitrary limitations on individual cost elements by Federal agencies. Provision for profit or other increment above cost is outside the scope of this Circular.

2. *Supersession.* This Circular supersedes cost principles issued by individual agencies for non-profit organizations.

3. *Applicability.*

a. These principles shall be used by all Federal agencies in determining the costs of work performed by non-profit organizations under grants, cooperative agreements, cost reimbursement contracts, and other contracts in which costs are used in pricing, administration, or settlement. All of these instruments are hereafter referred to as awards. The principles do not apply to awards under which an organization is not required to account to the Federal Government for actual costs incurred.

b. All cost reimbursement subawards (subgrants, subcontracts, etc.) are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a non-profit organization, this Circular shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial concerns shall apply; if a subaward is to a college or university, Circular A-21 shall apply; if a subaward is to a State, local, or federally-recognized Indian tribal government, Circular A-87 shall apply.

4. *Definitions.*

a. *Non-profit organization* means any corporation, trust, association, cooperative, or other organization which:

(1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;

(2) is not organized primarily for profit; and

(3) uses its net proceeds to maintain, improve, and/or expand its operations. For this purpose, the term "non-profit organization" excludes (i) colleges and universities; (ii) hospitals; (iii) State, local, and federally-recognized Indian tribal governments; and (iv) those non-profit organizations which are excluded from coverage of this Circular in accordance with paragraph 5.

b. *Prior approval* means securing the awarding agency's permission in advance to incur cost for those items that are designated as requiring prior approval by the Circular. Generally this permission will be in writing. Where an item of cost requiring prior approval is specified in the budget of an award, approval of the budget constitutes approval of that cost.

5. *Exclusion of some non-profit organizations.* Some non-profit organizations, because of their size and nature of operations, can be considered to be similar to commercial concerns for purpose of applicability of cost principles. Such non-profit organizations shall operate under Federal cost principles applicable to commercial concerns. A listing of these organizations is contained in Attachment C. Other organizations may be added from time to time.

6. *Responsibilities.* Agencies responsible for administering programs that involve awards to non-profit organizations shall implement the provisions of this Circular. Upon request, implementing instruction shall be furnished to OMB. Agencies shall designate a liaison official to serve as the agency representative on matters relating to the implementation of this Circular. The name and title of such representative shall be furnished to OMB within 30 days of the date of this Circular.

7. *Attachments.* The principles and related policy guides are set forth in the following Attachments:

Attachment A—General Principles
Attachment B—Selected Items of Cost
Attachment C—Non-Profit Organizations Not Subject To This Circular

8. *Requests for exceptions.* OMB may grant exceptions to the requirements of this Circular when permissible under existing law. However, in the interest of achieving maximum uniformity, exceptions will be permitted only in highly unusual circumstances.

9. *Effective Date.* The provisions of this Circular are effective immediately. Implementation shall be phased in by incorporating the provisions into new awards made after the start of the organization's next fiscal year. For existing awards, the new principles may be applied if an organization and the cognizant Federal agency agree. Earlier implementation, or a delay in implementation of individual provisions, is also permitted by mutual agreement between an organization and the cognizant Federal agency.

10. *Inquiries.* Further information concerning this Circular may be obtained by contacting the Office of Federal Financial Management, OMB, Washington, DC 20503, telephone (202) 395-3993.

Attachments

Circular No. A-122

Attachment A—General Principles

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Attachment A—General Principles

A. Basic Considerations

1. *Composition of total costs.* The total cost of an award is the sum of the allowable direct and allocable indirect costs less any applicable credits.

2. *Factors affecting allowability of costs.* To be allowable under an award, costs must meet the following general criteria:

a. Be reasonable for the performance of the award and be allocable thereto under these principles.

b. Conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items.

c. Be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the organization.

d. Be accorded consistent treatment.

e. Be determined in accordance with generally accepted accounting principles (GAAP).

f. Not be included as a cost or used to meet cost sharing or matching requirements of any other federally-financed program in either the current or a prior period.

g. Be adequately documented.

3. *Reasonable costs.* A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration shall be given to:

a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.

b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.

c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.

d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

4. *Allocable costs.*

a. A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

(1) Is incurred specifically for the award.

(2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or

(3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

b. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

5. *Applicable credits.*

a. The term applicable credits refers to those receipts, or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs. Typical examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing or received by the organization relate to allowable cost, they shall be credited to the Federal Government either as a cost reduction or cash refund, as appropriate.

b. In some instances, the amounts received from the Federal Government to finance organizational activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the organization in determining the rates or amounts to be charged to Federal awards for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by Federal funds.

c. For rules covering program income (i.e., gross income earned from federally-supported activities) see Sec. __.24 of Office of Management and Budget (OMB) Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations."

6. *Advance understandings.* Under any given award, the reasonableness and allocability of certain items of costs may be difficult to determine. This is particularly true in connection with organizations that receive a preponderance of their support from Federal agencies. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, it is often desirable to seek a written agreement with the cognizant or awarding agency in advance of the incurrence of special or unusual costs. The absence of an advance agreement on any element of cost will not, in itself, affect the reasonableness or allocability of that element.

*7. *Conditional exemptions.*

a. OMB authorizes conditional exemption from OMB administrative requirements and cost principles circulars for certain Federal programs with statutorily-authorized consolidated planning and consolidated administrative funding, that are identified by a Federal agency and approved by the head of the Executive department or establishment. A Federal agency shall consult with OMB during its consideration of whether to grant such an exemption.

b. To promote efficiency in State and local program administration, when Federal non-entitlement programs with common purposes have specific statutorily-authorized consolidated planning and consolidated administrative funding and where most of the State agency's resources come from non-Federal sources, Federal agencies may exempt these covered State-administered, non-entitlement grant programs from certain OMB grants management requirements. The exemptions would be from all but the allocability of costs provisions of OMB Circulars A-87 (Attachment A, subsection C.3), "Cost Principles for State, Local, and Indian Tribal Governments," A-21 (Section C, subpart 4), "Cost Principles for Educational Institutions," and A-122 (Attachment A, subsection A.4), "Cost Principles for Non-Profit Organizations," and from all of the administrative requirements provisions of OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," and the agencies' grants management common rule.

c. When a Federal agency provides this flexibility, as a prerequisite to a State's exercising this option, a State must adopt its own written fiscal and administrative requirements for expending and accounting for all funds, which are consistent with the provisions of OMB Circular A-87, and extend such policies to all subrecipients. These fiscal and administrative requirements must be sufficiently specific to ensure that: funds are used in compliance with all applicable federal statutory and regulatory provisions, costs are reasonable and necessary for operating these programs, and funds are not to be used for general

*Editor's note: Paragraph incorporates conditional program exemption OMB has authorized. See Aug. 29, 1997, *Federal Register*, pages 45934-45936.

expenses required to carry out other responsibilities of a State or its subrecipients.

B. Direct Costs

1. Direct costs are those that can be identified specifically with a particular final cost objective, i.e., a particular award, project, service, or other direct activity of an organization. However, a cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstance, has been allocated to an award as an indirect cost. Costs identified specifically with awards are direct costs of the awards and are to be assigned directly thereto. Costs identified specifically with other final cost objectives of the organization are direct costs of those cost objectives and are not to be assigned to other awards directly or indirectly.

2. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives.

3. The cost of certain activities are not allowable as charges to Federal awards (see, for example, fundraising costs in paragraph 19 of Attachment B). However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct costs for purposes of determining indirect cost rates and be allocated their share of the organization's indirect costs if they represent activities which (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs.

4. The costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs whether or not allowable and be allocated an equitable share of indirect costs. Some examples of these types of activities include:

a. Maintenance of membership rolls, subscriptions, publications, and related functions.

b. Providing services and information to members, legislative or administrative bodies, or the public.

c. Promotion, lobbying, and other forms of public relations.

d. Meetings and conferences except those held to conduct the general administration of the organization.

e. Maintenance, protection, and investment of special funds not used in operation of the organization.

f. Administration of group benefits on behalf of members or clients, including life and hospital insurance, annuity or retirement plans, financial aid, etc.

C. Indirect Costs

1. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Direct cost of minor amounts may be treated as indirect costs under the conditions described in subparagraph B.2. After direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives. A cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to an award as a direct cost.

2. Because of the diverse characteristics and accounting practices of non-profit organizations, it is not possible to specify the types of cost which may be classified as indirect cost in all situations. However, typical examples of indirect cost for many non-profit organizations may include depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, and general administration and general expenses, such as the salaries and expenses of executive officers, personnel administration, and accounting.

D. Allocation of Indirect Costs and Determination of Indirect Cost Rates

1. *General.*

a. Where a non-profit organization has only one major function, or where all its major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures, as described in subparagraph 2.

b. Where an organization has several major functions which benefit from its indirect costs in varying degrees, allocation of indirect costs may require the accumulation of such costs into separate cost groupings which then are allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. The indirect costs allocated to each function are then distributed to individual awards and other activities included in that function by means of an indirect cost rate(s).

c. The determination of what constitutes an organization's major functions will depend on its purpose in being; the types of services it renders to the public, its clients, and its members; and the amount of effort it devotes to such activities as fundraising, public information and membership activities.

d. Specific methods for allocating indirect costs and computing indirect cost rates along with the conditions under which each method should be used are described in subparagraphs 2 through 5.

e. The base period for the allocation of indirect costs is the period in which such costs are incurred and accumulated for allocation to work performed in that period. The base period normally should coincide with the organization's fiscal year but, in any event, shall be so selected as to avoid inequities in the allocation of the costs.

2. *Simplified allocation method.*

a. Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (i) separating the organization's total costs for the base period as either direct or indirect, and (ii) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual awards. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where an organization has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to an organization is relatively small.

b. Both the direct costs and the indirect costs shall exclude capital expenditures and unallowable costs. However, unallowable costs which represent activities must be included in the direct costs under the conditions described in subparagraph B.3.

c. The distribution base may be total direct costs (excluding capital expenditures and other distorting items, such as major subcontracts or subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 30 of Attachment B.

d. Except where a special rate(s) is required in accordance with subparagraph 5, the indirect cost rate developed under the

above principles is applicable to all awards at the organization. If a special rate(s) is required, appropriate modifications shall be made in order to develop the special rate(s).

3. *Multiple allocation base method.*

a. Where an organization's indirect costs benefit its major functions in varying degrees, such costs shall be accumulated into separate cost groupings. Each grouping shall then be allocated individually to benefiting functions by means of a base which best measures the relative benefits.

b. The groupings shall be established so as to permit the allocation of each grouping on the basis of benefits provided to the major functions. Each grouping should constitute a pool of expenses that are of like character in terms of the functions they benefit and in terms of the allocation base which best measures the relative benefits provided to each function. The number of separate groupings should be held within practical limits, taking into consideration the materiality of the amounts involved and the degree of precision desired.

c. Actual conditions must be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefiting functions. When an allocation can be made by assignment of a cost grouping directly to the function benefited, the allocation shall be made in that manner. When the expenses in a grouping are more general in nature, the allocation should be made through the use of a selected base which produces results that are equitable to both the Federal Government and the organization. In general, any cost element or cost related factor associated with the organization's work is potentially adaptable for use as an allocation base, provided (i) it can readily be expressed in terms of dollars or other quantitative measures (total direct costs, direct salaries and wages, staff hours applied, square feet used, hours of usage, number of documents processed, population served, and the like) and (ii) it is common to the benefiting functions during the base period.

d. Except where a special indirect cost rate(s) is required in accordance with subparagraph 5, the separate groupings of indirect costs allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual awards included in that function by use of a single indirect cost rate.

e. The distribution base used in computing the indirect cost rate for each function may be total direct costs (excluding capital expenditures and other distorting items such as major subcontracts and subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 30, Attachment B. An indirect cost rate should be developed for each separate indirect cost pool developed. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the distribution base identified with that pool.

4. *Direct allocation method.*

a. Some non-profit organizations treat all costs as direct costs except general administration and general expenses. These organizations generally separate their costs into three basic categories: (i) General administration and general expenses, (ii) fundraising, and (iii) other direct functions (including projects performed under Federal awards). Joint costs, such as depreciation, rental costs, operation and maintenance of facilities, telephone expenses, and the like are prorated individually as direct costs to each category and to each award or other activity using a base most appropriate to the particular cost being prorated.

b. This method is acceptable, provided each joint cost is prorated using a base which accurately measures the benefits provided to each award or other activity. The bases must be established in accordance with reasonable criteria, and be supported by current data. This method is compatible with the Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations issued jointly by the National Health Council, Inc., the National Assembly of Voluntary Health and Social Welfare Organizations, and the United Way of America.

c. Under this method, indirect costs consist exclusively of general administration and general expenses. In all other respects, the organization's indirect cost rates shall be computed in the same manner as that described in subparagraph 2.

5. *Special indirect cost rates.* In some instances, a single indirect cost rate for all activities of an organization or for each major function of the organization may not be appropriate, since it would not take into account those different factors which may substantially affect the indirect costs applicable to a particular segment of work. For this purpose, a particular segment of work may be that performed under a single award or it may consist of work under a group of awards performed in a common environment. These factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements used, or any combination thereof. When a particular segment of work is performed in an environment which appears to generate a significantly different level of indirect costs, provisions should be made for a separate indirect cost pool applicable to such work. The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used, provided it is determined that (i) the rate differs significantly from that which would have been obtained under subparagraphs 2, 3, and 4, and (ii) the volume of work to which the rate would apply is material.

E. Negotiation and Approval of Indirect Cost Rates

1. *Definitions.* As used in this section, the following terms have the meanings set forth below:

a. *Cognizant agency* means the Federal agency responsible for negotiating and approving indirect cost rates for a non-profit organization on behalf of all Federal agencies.

b. *Predetermined rate* means an indirect cost rate, applicable to a specified current or future period, usually the organization's fiscal year. The rate is based on an estimate of the costs to be incurred during the period. A predetermined rate is not subject to adjustment.

c. *Fixed rate* means an indirect cost rate which has the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.

d. *Final rate* means an indirect cost rate applicable to a specified past period which is based on the actual costs of the period. A final rate is not subject to adjustment.

e. *Provisional rate* or billing rate means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on awards pending the establishment of a final rate for the period.

f. *Indirect cost proposal* means the documentation prepared by an organization to substantiate its claim for the reimbursement

of indirect costs. This proposal provides the basis for the review and negotiation leading to the establishment of an organization's indirect cost rate.

g. *Cost objective* means a function, organizational subdivision, contract, grant, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

2. *Negotiation and approval of rates.*

a. Unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards with an organization will be designated as the cognizant agency for the negotiation and approval of the indirect cost rates and, where necessary, other rates such as fringe benefit and computer charge-out rates. Once an agency is assigned cognizance for a particular non-profit organization, the assignment will not be changed unless there is a major long-term shift in the dollar volume of the Federal awards to the organization. All concerned Federal agencies shall be given the opportunity to participate in the negotiation process but, after a rate has been agreed upon, it will be accepted by all Federal agencies. When a Federal agency has reason to believe that special operating factors affecting its awards necessitate special indirect cost rates in accordance with subparagraph D.5, it will, prior to the time the rates are negotiated, notify the cognizant agency.

b. A non-profit organization which has not previously established an indirect cost rate with a Federal agency shall submit its initial indirect cost proposal immediately after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award.

c. Organizations that have previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year.

d. A predetermined rate may be negotiated for use on awards where there is reasonable assurance, based on past experience and reliable projection of the organization's costs, that the rate is not likely to exceed a rate based on the organization's actual costs.

e. Fixed rates may be negotiated where predetermined rates are not considered appropriate. A fixed rate, however, shall not be negotiated if (i) all or a substantial portion of the organization's awards are expected to expire before the carry-forward adjustment can be made; (ii) the mix of Federal and non-Federal work at the organization is too erratic to permit an equitable carry-forward adjustment; or (iii) the organization's operations fluctuate significantly from year to year.

f. Provisional and final rates shall be negotiated where neither predetermined nor fixed rates are appropriate.

g. The results of each negotiation shall be formalized in a written agreement between the cognizant agency and the non-profit organization. The cognizant agency shall distribute copies of the agreement to all concerned Federal agencies.

h. If a dispute arises in a negotiation of an indirect cost rate between the cognizant agency and the non-profit organization, the dispute shall be resolved in accordance with the appeals procedures of the cognizant agency.

i. To the extent that problems are encountered among the Federal agencies in connection with the negotiation and approval process, OMB will lend assistance as required to resolve such problems in a timely manner.

Attachment B—Selected Items of Cost

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Attachment B—Selected Items of Cost

Paragraphs 1 through 51 provide principles to be applied in establishing the allowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather, determination as to allowability in each case should be based on the treatment or principles provided for similar or related items of cost.

1. *Advertising costs.*

a. Advertising costs mean the costs of media services and associated costs. Media advertising includes magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.

b. The only advertising costs allowable are those which are solely for (i) the recruitment of personnel when considered in conjunction with all other recruitment costs, as set forth in paragraph 41; (ii) the procurement of goods and services; (iii) the disposal of surplus materials acquired in the performance of the award except when organizations are reimbursed for disposals at a predetermined amount in accordance with Office of Management and Budget (OMB) Circular A-110, "Uniform Administrative

Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations;" or (iv) specific requirements of the award.

2. *Bad debts.* Bad debts, including losses (whether actual or estimated) arising from uncollectible accounts and other claims, related collection costs, and related legal costs, are unallowable.

3. *Bid and proposal costs.* (reserved)

4. *Bonding costs.*

a. Bonding costs arise when the Federal Government requires assurance against financial loss to itself or others by reason of the act or default of the organization. They arise also in instances where the organization requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

b. Costs of bonding required pursuant to the terms of the award are allowable.

c. Costs of bonding required by the organization in the general conduct of its operations are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

5. *Communication costs.* Costs incurred for telephone services, local and long distance telephone calls, telegrams, radiograms, postage and the like are allowable.

6. *Compensation for personal services.*

a. *Definition.* Compensation for personal services includes all compensation paid currently or accrued by the organization for services of employees rendered during the period of the award (except as otherwise provided in subparagraph g). It includes, but is not limited to, salaries, wages, director's and executive committee member's fees, incentive awards, fringe benefits, pension plan costs, allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost of living differentials.

b. *Allowability.* Except as otherwise specifically provided in this paragraph, the costs of such compensation are allowable to the extent that:

(1) Total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the organization consistently applied to both Federal and non-Federal activities; and

(2) Charges to awards whether treated as direct or indirect costs are determined and supported as required in this paragraph.

c. *Reasonableness.*

(1) When the organization is predominantly engaged in activities other than those sponsored by the Federal Government, compensation for employees on federally-sponsored work will be considered reasonable to the extent that it is consistent with that paid for similar work in the organization's other activities.

(2) When the organization is predominantly engaged in federally-sponsored activities and in cases where the kind of employees required for the Federal activities are not found in the organization's other activities, compensation for employees on federally-sponsored work will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved.

d. *Special considerations in determining allowability.* Certain conditions require special consideration and possible limitations in determining costs under Federal awards where amounts or types of compensation appear unreasonable. Among such conditions are the following:

(1) Compensation to members of nonprofit organizations, trustees, directors, associates, officers, or the immediate families thereof. Determination should be made that such compensation is reasonable for the actual personal services rendered rather than a distribution of earnings in excess of costs.

(2) Any change in an organization's compensation policy resulting in a substantial increase in the organization's level of compensation, particularly when it was concurrent with an increase in the ratio of Federal awards to other activities of the organization or any change in the treatment of allowability of specific types of compensation due to changes in Federal policy.

e. *Unallowable costs.* Costs which are unallowable under other paragraphs of this Attachment shall not be allowable under this paragraph solely on the basis that they constitute personal compensation.

f. *Fringe benefits.*

(1) Fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as vacation leave, sick leave, military leave, and the like, are allowable, provided such costs are absorbed by all organization activities in proportion to the relative amount of time or effort actually devoted to each.

(2) Fringe benefits in the form of employer contributions or expenses for social security, employee insurance, workmen's compensation insurance, pension plan costs (see subparagraph g), and the like, are allowable, provided such benefits are granted in accordance with established written organization policies. Such benefits whether treated as indirect costs or as direct costs, shall be distributed to particular awards and other activities in a manner consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such awards and other activities.

(3) (a) Provisions for a reserve under a self-insurance program for unemployment compensation or workers' compensation are allowable to the extent that the provisions represent reasonable estimates of the liabilities for such compensation, and the types of coverage, extent of coverage, and rates and premiums would have been allowable had insurance been purchased to cover the risks. However, provisions for self-insured liabilities which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(b) Where an organization follows a consistent policy of expensing actual payments to, or on behalf of, employees or former employees for unemployment compensation or workers' compensation, such payments are allowable in the year of payment with the prior approval of the awarding agency, provided they are allocated to all activities of the organization.

(4) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibility are allowable only to the extent that the insurance represents additional compensation. The costs of such insurance when the organization is named as beneficiary are unallowable.

g. *Pension plan costs.*

(1) Costs of the organization's pension plan which are incurred in accordance with the established policies of the organization are allowable, provided:

(a) Such policies meet the test of reasonableness;

(b) The methods of cost allocation are not discriminatory;

(c) The cost assigned to each fiscal year is determined in accordance with generally accepted accounting principles (GAAP), as prescribed in Accounting Principles Board Opinion No. 8 issued by the American Institute of Certified Public Accountants; and

(d) The costs assigned to a given fiscal year are funded for all plan participants within six months after the end of that year. However, increases to normal and past service pension costs caused by a delay in funding the actuarial liability beyond 30

days after each quarter of the year to which such costs are assignable are unallowable.

(2) Pension plan termination insurance premiums paid pursuant to the Employee Retirement Income Security Act (ERISA) of 1974 (Pub. L. 93-406) are allowable. Late payment charges on such premiums are unallowable.

(3) Excise taxes on accumulated funding deficiencies and other penalties imposed under ERISA are unallowable.

h. *Incentive compensation.* Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the organization and the employees before the services were rendered, or pursuant to an established plan followed by the organization so consistently as to imply, in effect, an agreement to make such payment.

i. *Overtime, extra pay shift, and multi-shift premiums.* See paragraph 28.

j. *Severance pay.* See paragraph 45.

k. *Training and education costs.* See paragraph 49.

l. *Support of salaries and wages.*

(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph (2), except when a substitute system has been approved in writing by the cognizant agency. (See subparagraph E.2 of Attachment A.)

(2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:

(a) The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

(b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

(c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.

(d) The reports must be prepared at least monthly and must coincide with one or more pay periods.

(3) Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described in subparagraphs (1) and (2), must also be supported by records indicating the total number of hours worked each day maintained in conformance with Department of Labor regulations implementing the Fair Labor Standards Act (FLSA) (29 CFR Part 516). For this purpose, the term "nonprofessional employee" shall have the same meaning as "nonexempt employee," under FLSA.

(4) Salaries and wages of employees used in meeting cost sharing or matching requirements on awards must be supported in the same manner as salaries and wages claimed for reimbursement from awarding agencies.

7. *Contingency provisions.* Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see subparagraphs 6.f (3) and 18.a(2)(d); pension funds (see subparagraph 6.g); and reserves for normal severance pay (see subparagraph 45.b(1)).

8. *Contributions.* Contributions and donations by the organization to others are unallowable.

9. *Depreciation and use allowances.*

a. Compensation for the use of buildings, other capital improvements, and equipment on hand may be made through use allowances or depreciation. However, except as provided in subparagraph f, a combination of the two methods may not be used in connection with a single class of fixed assets (e.g., buildings, office equipment, computer equipment, etc.).

b. The computation of use allowances or depreciation shall be based on the acquisition cost of the assets involved. The acquisition cost of an asset donated to the organization by a third party shall be its fair market value at the time of the donation.

c. The computation of use allowances or depreciation will exclude:

(1) The cost of land;

(2) Any portion of the cost of buildings and equipment borne by or donated by the Federal Government irrespective of where title was originally vested or where it presently resides; and

(3) Any portion of the cost of buildings and equipment contributed by or for the organization in satisfaction of a statutory matching requirement.

d. Where the use allowance method is followed, the use allowance for buildings and improvement (including land improvements, such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost. When the use allowance method is used for buildings, the entire building must be treated as a single asset; the building's components (e.g., plumbing system, heating and air conditioning, etc.) cannot be segregated from the building's shell. The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the need for costly or extensive alterations or repairs to the building or the equipment. Equipment that meets these criteria will be subject to the six and two-thirds percent equipment use allowance limitation.

e. Where depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular program area, and the renewal and replacement policies followed

for the individual items or classes of assets involved. The method of depreciation used to assign the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater or lesser in the early portions of its useful life than in the later portions, the straight-line method shall be presumed to be the appropriate method. Depreciation methods once used shall not be changed unless approved in advance by the cognizant Federal agency. When the depreciation method is introduced for application to assets previously subject to a use allowance, the combination of use allowances and depreciation applicable to such assets must not exceed the total acquisition cost of the assets. When the depreciation method is used for buildings, a building's shell may be segregated from each building component (e.g., plumbing system, heating, and air conditioning system, etc.) and each item depreciated over its estimated useful life; or the entire building (i.e., the shell and all components) may be treated as a single asset and depreciated over a single useful life.

f. When the depreciation method is used for a particular class of assets, no depreciation may be allowed on any such assets that, under subparagraph e, would be viewed as fully depreciated. However, a reasonable use allowance may be negotiated for such assets if warranted after taking into consideration the amount of depreciation previously charged to the Federal Government, the estimated useful life remaining at time of negotiation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

g. Charges for use allowances or depreciation must be supported by adequate property records and physical inventories must be taken at least once every two years (a statistical sampling basis is acceptable) to ensure that assets exist and are usable and needed. When the depreciation method is followed, adequate depreciation records indicating the amount of depreciation taken each period must also be maintained.

10. *Donations.*

a. *Services received.*

(1) Donated or volunteer services may be furnished to an organization by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost.

(2) The value of donated services utilized in the performance of a direct cost activity shall be considered in the determination of the organization's indirect cost rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs when the following circumstances exist:

(a) The aggregate value of the services is material;

(b) The services are supported by a significant amount of the indirect costs incurred by the organization;

(c) The direct cost activity is not pursued primarily for the benefit of the Federal Government,

(3) In those instances where there is no basis for determining the fair market value of the services rendered, the recipient and the cognizant agency shall negotiate an appropriate allocation of indirect cost to the services.

(4) Where donated services directly benefit a project supported by an award, the indirect costs allocated to the services will be considered as a part of the total costs of the project. Such indirect costs may be reimbursed under the award or used to meet cost sharing or matching requirements.

(5) The value of the donated services may be used to meet cost sharing or matching requirements under conditions described in Sec. __.23 of Circular A-110. Where donated services are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

(6) Fair market value of donated services shall be computed as follows:

(a) *Rates for volunteer services.* Rates for volunteers shall be consistent with those regular rates paid for similar work in other activities of the organization. In cases where the kinds of skills involved are not found in other activities of the organization, the rates used shall be consistent with those paid for similar work in the labor market in which the organization competes for such skills.

(b) *Services donated by other organizations.* When an employer donates the services of an employee, these services shall be valued at the employee's regular rate of pay (exclusive of fringe benefits and indirect costs), provided the services are in the same skill for which the employee is normally paid. If the services are not in the same skill for which the employee is normally paid, fair market value shall be computed in accordance with subparagraph (a).

b. *Goods and space.*

(1) Donated goods; i.e., expendable personal property/supplies, and donated use of space may be furnished to an organization. The value of the goods and space is not reimbursable either as a direct or indirect cost.

(2) The value of the donations may be used to meet cost sharing or matching share requirements under the conditions described in Sec. __.23 of Circular A-110. The value of the donations shall be determined in accordance with Sec. __.23 of Circular A-110. Where donations are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

11. *Employee morale, health, and welfare costs and credits.* The costs of house publications, health or first-aid clinics, and/or infirmaries, recreational activities, employees' counseling services, and other expenses incurred in accordance with the organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable. Such costs will be equitably apportioned to all activities of the organization. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.

12. *Entertainment costs.* Costs of amusement, diversion, social activities, ceremonials, and costs relating thereto, such as meals, lodging, rentals, transportation, and gratuities are unallowable (but see paragraphs 11 and 26).

13. *Equipment and other capital expenditures.*

a. As used in this paragraph, the following terms have the meanings set forth below:

(1) *Equipment* means an article of nonexpendable tangible personal property having a useful life of more than two years and an acquisition cost of $500 or more per unit. An organization may use its own definition, provided that it at least includes all nonexpendable tangible personal property as defined herein.

(2) *Acquisition cost* means the net invoice unit price of an item of equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective in-transit insurance, freight, and installation shall be included in or excluded from acquisition cost

in accordance with the organization's regular written accounting practices.

(3) *Special purpose equipment* means equipment which is usable only for research, medical, scientific, or technical activities. Examples of special purpose equipment include microscopes, x-ray machines, surgical instruments, and spectrometers.

(4) *General purpose equipment* means equipment which is usable for other than research, medical, scientific, or technical activities, whether or not special modifications are needed to make them suitable for a particular purpose. Examples of general purpose equipment include office equipment and furnishings, air conditioning equipment, reproduction and printing equipment, motor vehicles, and automatic data processing equipment.

b. (1) Capital expenditures for general purpose equipment are unallowable as a direct cost except with the prior approval of the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of $1000 or more have the prior approval of the awarding agency.

c. Capital expenditures for land or buildings are unallowable as a direct cost except with the prior approval of the awarding agency.

d. Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior approval of the awarding agency.

e. Equipment and other capital expenditures are unallowable as indirect costs. However, see paragraph 9 for allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see paragraph 43 for allowability of rental costs for land, buildings, and equipment.

14. *Fines and penalties.* Costs of fines and penalties resulting from violations of, or failure of the organization to comply with Federal, State, and local laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of an award or instructions in writing from the awarding agency.

15. *Fringe benefits.* See subparagraph 6.f.

16. *Idle facilities and idle capacity.*

a. As used in this paragraph, the following terms have the meanings set forth below:

(1) *Facilities* means land and buildings or any portion thereof, equipment individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the organization.

(2) *Idle facilities* means completely unused facilities that are excess to the organization's current needs.

(3) *Idle capacity* means the unused capacity of partially used facilities. It is the difference between that which a facility could achieve under 100 percent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays, and the extent to which the facility was actually used to meet demands during the accounting period. A multi-shift basis may be used if it can be shown that this amount of usage could normally be expected for the type of facility involved.

(4) *Costs of idle facilities or idle capacity* means costs such as maintenance, repair, housing, rent, and other related costs, e.g., property taxes, insurance, and depreciation or use allowances.

b. The costs of idle facilities are unallowable except to the extent that:

(1) They are necessary to meet fluctuations in workload; or

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subparagraph, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending upon the initiative taken to use, lease, or dispose of such facilities (but see subparagraphs 48.b and d).

c. The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be idle facilities.

17. *Independent research and development.* [Reserved]

18. *Insurance and indemnification.*

a. Insurance includes insurance which the organization is required to carry, or which is approved, under the terms of the award and any other insurance which the organization maintains in connection with the general conduct of its operations. This paragraph does not apply to insurance which represents fringe benefits for employees (see subparagraphs 6.f and 6.g(2)).

(1) Costs of insurance required or approved, and maintained, pursuant to the award are allowable.

(2) Costs of other insurance maintained by the organization in connection with the general conduct of its operations are allowable subject to the following limitations:

(a) Types and extent of coverage shall be in accordance with sound business practice and the rates and premiums shall be reasonable under the circumstances.

(b) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of management fees.

(c) Costs of insurance or of any provisions for a reserve covering the risk of loss or damage to Federal property are allowable only to the extent that the organization is liable for such loss or damage.

(d) Provisions for a reserve under a self-insurance program are allowable to the extent that types of coverage, extent of coverage, rates, and premiums would have been allowed had insurance been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made, shall not exceed the present value of the liability.

(e) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibilities are allowable only to the extent that the insurance represents additional compensation (see subparagraph 6.f(4)). The cost of such insurance when the organization is identified as the beneficiary is unallowable.

(3) Actual losses which could have been covered by permissible insurance (through the purchase of insurance or a self-insurance program) are unallowable unless expressly provided for in the award, except:

(a) Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound business practice are allowable.

(b) Minor losses not covered by insurance, such as spoilage, breakage, and disappearance of supplies, which occur in the ordinary course of operations, are allowable.

b. Indemnification includes securing the organization against liabilities to third

persons and any other loss or damage, not compensated by insurance or otherwise. The Federal Government is obligated to indemnify the organization only to the extent expressly provided in the award.

19. *Interest, fundraising, and investment management costs.*

a. Interest.

(1) Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable. However, interest on debt incurred after the effective date of this revision to acquire or replace capital assets (including renovations, alterations, equipment, land, and capital assets acquired through capital leases), acquired after the effective date of this revision and used in support of sponsored agreements is allowable, provided that:

(a) For facilities acquisitions (excluding renovations and alterations) costing over $10 million where the Federal Government's reimbursement is expected to equal or exceed 40 percent of an asset's cost, the non-profit organization prepares, prior to the acquisition or replacement of the capital asset(s), a justification that demonstrates the need for the facility in the conduct of federally-sponsored activities. Upon request, the needs justification must be provided to the Federal agency with cost cognizance authority as a prerequisite to the continued allowability of interest on debt and depreciation related to the facility. The needs justification for the acquisition of a facility should include, at a minimum, the following:

- A statement of purpose and justification for facility acquisition or replacement.
- A statement as to why current facilities are not adequate.
- A statement of planned future use of the facility.
- A description of the financing agreement to be arranged for the facility.
- A summary of the building contract with estimated cost information and statement of source and use of funds.
- A schedule of planned occupancy dates.

(b) For facilities costing over $500,000, the non-profit organization prepares, prior to the acquisition or replacement of the facility, a lease/purchase analysis in accordance with the provisions of Sec. __.30 through __.37 of Circular A-110, which shows that a financed purchase or capital lease is less costly to the organization than other leasing alternatives, on a net present value basis. Discount rates used should be equal to the non-profit organization's anticipated interest rates and should be no higher than the fair market rate available to the non-profit organization from an unrelated ("arm's length") third-party. The lease/purchase analysis shall include a comparison of the net present value of the projected total cost comparisons of both alternatives over the period the asset is expected to be used by the non-profit organization. The cost comparisons associated with purchasing the facility shall include the estimated purchase price, anticipated operating and maintenance costs (including property taxes, if applicable) not included in the debt financing, less any estimated asset salvage value at the end of the period defined above. The cost comparison for a capital lease shall include the estimated total lease payments, any estimated bargain purchase option, operating and maintenance costs, and taxes not included in the capital leasing arrangement, less any estimated credits due under the lease at the end of the period defined above. Projected operating lease costs shall be based on the anticipated cost of leasing comparable facilities at fair market rates under rental agreements that would be renewed or reestablished over the period defined above, and any expected maintenance costs and allowable property taxes to be borne by the non-profit organization directly or as part of the lease arrangement.

(c) The actual interest cost claimed is predicated upon interest rates that are no higher than the fair market rate available to the non-profit organization from an unrelated ("arm's length") third party.

(d) Investment earnings, including interest income, on bond or loan principal, pending payment of the construction or acquisition costs, are used to offset allowable interest cost. Arbitrage earnings reportable to the Internal Revenue Service are not required to be offset against allowable interest costs.

(e) Reimbursements are limited to the least costly alternative based on the total cost analysis required under subparagraph (b). For example, if an operating lease is determined to be less costly than purchasing through debt financing, then reimbursement is limited to the amount determined if leasing had been used. In all cases where a lease/purchase analysis is performed, Federal reimbursement shall be based upon the least expensive alternative.

(f) Non-profit organizations are also subject to the following conditions:

(i) Interest on debt incurred to finance or refinance assets acquired before or reacquired after the effective date of this Circular is not allowable.

(ii) For debt arrangements over $1 million, unless the non-profit organization makes an initial equity contribution to the asset purchase of 25 percent or more, non-profit organizations shall reduce claims for interest expense by an amount equal to imputed interest earnings on excess cash flow, which is to be calculated as follows. Annually, non-profit organizations shall prepare a cumulative (from the inception of the project) report of monthly cash flows that includes inflows and outflows, regardless of the funding source. Inflows consist of depreciation expense, amortization of capitalized construction interest, and annual interest expense. For cash flow calculations, the annual inflow figures shall be divided by the number of months in the year (usually 12) that the building is in service for monthly amounts. Outflows consist of initial equity contributions, debt principal payments (less the pro rata share attributable to the unallowable costs of land) and interest payments. Where cumulative inflows exceed cumulative outflows, interest shall be calculated on the excess inflows for that period and be treated as a reduction to allowable interest expense. The rate of interest to be used to compute earnings on excess cash flows shall be the three month Treasury Bill closing rate as of the last business day of that month.

(iii) Substantial relocation of federally-sponsored activities from a facility financed by indebtedness, the cost of which was funded in whole or part through Federal reimbursements, to another facility prior to the expiration of a period of 20 years requires notice to the Federal cognizant agency. The extent of the relocation, the amount of the Federal participation in the financing, and the depreciation and interest charged to date may require negotiation and/or downward adjustments of replacement space charged to Federal programs in the future.

(iv) The allowable costs to acquire facilities and equipment are limited to a fair market value available to the non-profit organization from an unrelated ("arm's length") third party.

(2) For non-profit organizations subject to "full coverage" under the Cost Accounting Standards (CAS) as defined at 48 CFR 9903.201, the interest allowability provisions of subparagraph a do not apply. Instead, these organizations' sponsored agreements are subject to CAS 414 (48 CFR

9903.414), cost of money as an element of the cost of facilities capital, and CAS 417 (48 CFR 9903.417), cost of money as an element of the cost of capital assets under construction.

(3) The following definitions are to be used for purposes of paragraph 19:

(a) *Re-acquired assets* means assets held by the non-profit organization prior to the effective date of this revision that have again come to be held by the organization, whether through repurchase or refinancing. It does not include assets acquired to replace older assets.

(b) *Initial equity contribution* means the amount or value of contributions made by non-Federal entities for the acquisition of the asset or prior to occupancy of facilities.

(c) *Asset costs* means the capitalizable costs of an asset, including construction costs, acquisition costs, and other such costs capitalized in accordance with GAAP.

b. Costs of organized fundraising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are unallowable.

c. Costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments are unallowable.

d. Fundraising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in subparagraph B.3 of Attachment A.

20. *Labor relations costs.* Costs incurred in maintaining satisfactory relations between the organization and its employees, including costs of labor management committees, employee publications, and other related activities are allowable.

21. *Lobbying.*

a. Notwithstanding other provisions of this Circular, costs associated with the following activities are unallowable:

(1) Attempts to influence the outcomes of any Federal, State, or local election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activity;

(2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections;

(3) Any attempt to influence: (i) The introduction of Federal or State legislation; or (ii) the enactment or modification of any pending Federal or State legislation through communication with any member or employee of the Congress or State legislature (including efforts to influence State or local officials to engage in similar lobbying activity), or with any Government official or employee in connection with a decision to sign or veto enrolled legislation;

(4) Any attempt to influence: (i) The introduction of Federal or State legislation; or (ii) the enactment or modification of any pending Federal or State legislation by preparing, distributing or using publicity or propaganda, or by urging members of the general public or any segment thereof to contribute to or participate in any mass demonstration, march, rally, fundraising drive, lobbying campaign or letter writing or telephone campaign; or

(5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable lobbying.

b. The following activities are excepted from the coverage of subparagraph a:

(1) Providing a technical and factual presentation of information on a topic directly related to the performance of a grant, contract or other agreement through hearing testimony, statements or letters to the Congress or a State legislature, or subdivision, member, or cognizant staff member thereof, in response to a documented request (including a Congressional Record notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof; provided such information is readily obtainable and can be readily put in deliverable form; and further provided that costs under this section for travel, lodging or meals are unallowable unless incurred to offer testimony at a regularly scheduled Congressional hearing pursuant to a written request for such presentation made by the Chairman or Ranking Minority Member of the Committee or Subcommittee conducting such hearing.

(2) Any lobbying made unallowable by subparagraph a(3) to influence State legislation in order to directly reduce the cost, or to avoid material impairment of the organization's authority to perform the grant, contract, or other agreement.

(3) Any activity specifically authorized by statute to be undertaken with funds from the grant, contract, or other agreement.

c. (1) When an organization seeks reimbursement for indirect costs, total lobbying costs shall be separately identified in the indirect cost rate proposal, and thereafter treated as other unallowable activity costs in accordance with the procedures of subparagraph B.3 of Attachment A.

(2) Organizations shall submit, as part of the annual indirect cost rate proposal, a certification that the requirements and standards of this paragraph have been complied with.

(3) Organizations shall maintain adequate records to demonstrate that the determination of costs as being allowable or unallowable pursuant to paragraph 21 complies with the requirements of this Circular.

(4) Time logs, calendars, or similar records shall not be required to be created for purposes of complying with this paragraph during any particular calendar month when: (1) The employee engages in lobbying (as defined in subparagraphs (a) and (b)) 25 percent or less of the employee's compensated hours of employment during that calendar month, and (2) within the preceding five-year period, the organization has not materially misstated allowable or unallowable costs of any nature, including legislative lobbying costs. When conditions (1) and (2) are met, organizations are not required to establish records to support the allowability of claimed costs in addition to records already required or maintained. Also, when conditions (1) and (2) are met, the absence of time logs, calendars, or similar records will not serve as a basis for disallowing costs by contesting estimates of lobbying time spent by employees during a calendar month.

(5) Agencies shall establish procedures for resolving in advance, in consultation with OMB, any significant questions or disagreements concerning the interpretation or application of paragraph 21. Any such advance resolution shall be binding in any subsequent settlements, audits or investigations with respect to that grant or contract for purposes of interpretation of this Circular; provided, however, that this shall not be construed to prevent a contractor or grantee from contesting the lawfulness of such a determination.

22. *Losses on other awards.* Any excess of costs over income on any award is unallowable as a cost of any other award. This includes, but is not limited to, the organization's contributed portion by reason of cost sharing agreements or any under-recoveries through negotiation of lump sums for, or ceilings on, indirect costs.

23. *Maintenance and repair costs.* Costs incurred for necessary maintenance, repair,

or upkeep of buildings and equipment (including Federal property unless otherwise provided for) which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are allowable. Costs incurred for improvements which add to the permanent value of the buildings and equipment or appreciably prolong their intended life shall be treated as capital expenditures (see paragraph 13).

24. *Materials and supplies.* The costs of materials and supplies necessary to carry out an award are allowable. Such costs should be charged at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the organization. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing consistently applied. Incoming transportation charges may be a proper part of material cost. Materials and supplies charged as a direct cost should include only the materials and supplies actually used for the performance of the contract or grant, and due credit should be given for any excess materials or supplies retained, or returned to vendors.

25. *Meetings and conferences.*

a. Costs associated with the conduct of meetings and conferences include the cost of renting facilities, meals, speakers' fees, and the like. But see paragraph 12, Entertainment costs, and paragraph 30, Participant support costs.

b. To the extent that these costs are identifiable with a particular cost objective, they should be charged to that objective (see paragraph B of Attachment A). These costs are allowable, provided that they meet the general tests of allowability, shown in paragraph A of Attachment A to this Circular.

c. Costs of meetings and conferences held to conduct the general administration of the organization are allowable.

26. *Memberships, subscriptions, and professional activity costs.*

a. Costs of the organization's membership in civic, business, technical and professional organizations are allowable.

b. Costs of the organization's subscriptions to civic, business, professional, and technical periodicals are allowable.

c. Costs of attendance at meetings and conferences sponsored by others when the primary purpose is the dissemination of technical information are allowable. This includes costs of meals, transportation, and other items incidental to such attendance.

27. *Organization costs.* Expenditures, such as incorporation fees, brokers' fees, fees to promoters, organizers or management consultants, attorneys, accountants, or investment counselors, whether or not employees of the organization, in connection with establishment or reorganization of an organization, are unallowable except with prior approval of the awarding agency.

28. *Overtime, extra-pay shift, and multi-shift premiums.* Premiums for overtime, extra-pay shifts, and multi-shift work are allowable only with the prior approval of the awarding agency except:

a. When necessary to cope with emergencies, such as those resulting from accidents, natural disasters, breakdowns of equipment, or occasional operational bottlenecks of a sporadic nature.

b. When employees are performing indirect functions, such as administration, maintenance, or accounting.

c. In the performance of tests, laboratory procedures, or other similar operations which are continuous in nature and cannot reasonably be interrupted or otherwise completed.

d. When lower overall cost to the Federal Government will result.

29. *Page charges in professional journals.* Page charges for professional journal publications are allowable as a necessary part of research costs, where:

a. The research papers report work supported by the Federal Government; and

b. The charges are levied impartially on all research papers published by the journal, whether or not by federally-sponsored authors.

30. *Participant support costs.* Participant support costs are direct costs for items such as stipends or subsistence allowances, travel allowances, and registration fees paid to or on behalf of participants or trainees (but not employees) in connection with meetings, conferences, symposia, or training projects. These costs are allowable with the prior approval of the awarding agency.

31. *Patent costs.*

a. Costs of (i) preparing disclosures, reports, and other documents required by the award and of searching the art to the extent necessary to make such disclosures, (ii) preparing documents and any other patent costs in connection with the filing and prosecution of a United States patent application where title or royalty-free license is required by the Federal Government to be conveyed to the Federal Government, and (iii) general counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements are allowable (but see paragraph 35).

b. Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures, if not required by the award, are unallowable. Costs in connection with (i) filing and prosecuting any foreign patent application, or (ii) any United States patent application, where the award does not require conveying title or a royalty-free license to the Federal Government, are unallowable (also see paragraph 44).

32. *Pension plans.* See subparagraph 6.g.

33. *Plant security costs.* Necessary expenses incurred to comply with Federal security requirements or for facilities protection, including wages, uniforms, and equipment of personnel are allowable.

34. *Pre-award costs.* Pre-award costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

35. *Professional service costs.*

a. Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the organization, are allowable, subject to subparagraphs b, c, and d when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal Government.

b. In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relevant:

(1) The nature and scope of the service rendered in relation to the service required.

(2) The necessity of contracting for the service, considering the organization's capability in the particular area.

(3) The past pattern of such costs, particularly in the years prior to Federal awards.

(4) The impact of Federal awards on the organization's business (i.e., what new problems have arisen).

(5) Whether the proportion of Federal work to the organization's total business is

such as to influence the organization in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Federal grants and contracts.

(6) Whether the service can be performed more economically by direct employment rather than contracting.

(7) The qualifications of the individual or concern rendering the service and the customary fees charged, especially on non-Federal awards.

(8) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).

c. In addition to the factors in subparagraph b, retainer fees to be allowable must be supported by evidence of bona fide services available or rendered.

d. Cost of legal, accounting, and consulting services, and related costs incurred in connection with defense of antitrust suits, and the prosecution of claims against the Federal Government, are unallowable. Costs of legal, accounting and consulting services, and related costs, incurred in connection with patent infringement litigation, organization and reorganization, are unallowable unless otherwise provided for in the award (but see subparagraph 48.e).

36. *Profits and losses on disposition of depreciable property or other capital assets.*

a. (1) Gains and losses on sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to cost grouping(s) in which the depreciation applicable to such property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate cost grouping(s) shall be the difference between the amount realized on the property and the undepreciated basis of the property.

(2) Gains and losses on the disposition of depreciable property shall not be recognized as a separate credit or charge under the following conditions:

(a) The gain or loss is processed through a depreciation reserve account and is reflected in the depreciation allowable under paragraph 9.

(b) The property is given in exchange as part of the purchase price of a similar item and the gain or loss is taken into account in determining the depreciation cost basis of the new item.

(c) A loss results from the failure to maintain permissible insurance, except as otherwise provided in subparagraph 18.a(3).

(d) Compensation for the use of the property was provided through use allowances in lieu of depreciation in accordance with paragraph 9.

(e) Gains and losses arising from mass or extraordinary sales, retirements, or other dispositions shall be considered on a case-by-case basis.

b. Gains or losses of any nature arising from the sale or exchange of property other than the property covered in subparagraph a shall be excluded in computing award costs.

37. *Public information service costs.*

a. Public information service costs include the costs associated with pamphlets, news releases, and other forms of information services. Such costs are normally incurred to:

(1) Inform or instruct individuals, groups, or the general public.

(2) Interest individuals or groups in participating in a service program of the organization.

(3) Disseminate the results of sponsored and nonsponsored activities.

b. Public information service costs are allowable as direct costs with the prior approval of the awarding agency. Such costs are unallowable as indirect costs.

38. *Publication and printing costs.*

a. Publication costs include the costs of printing (including the processes of composition, plate-making, press work, binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling.

b. If these costs are not identifiable with a particular cost objective, they should be allocated as indirect costs to all benefiting activities of the organization.

c. Publication and printing costs are unallowable as direct costs except with the prior approval of the awarding agency.

d. The cost of page charges in journals is addressed in paragraph 29.

39. *Rearrangement and alteration costs.* Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special arrangement and alteration costs incurred specifically for the project are allowable with the prior approval of the awarding agency.

40. *Reconversion costs.* Costs incurred in the restoration or rehabilitation of the organization's facilities to approximately the same condition existing immediately prior to commencement of Federal awards, fair wear and tear excepted, are allowable.

41. *Recruiting costs.* The following recruiting costs are allowable: cost of "help wanted" advertising, operating costs of an employment office, costs of operating an educational testing program, travel expenses including food and lodging of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees (see subparagraph 42.c). Where the organization uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

42. *Relocation costs.*

a. Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period of not less than 12 months) of an existing employee or upon recruitment of a new employee. Relocation costs are allowable, subject to the limitation described in subparagraphs b, c, and d, provided that:

(1) The move is for the benefit of the employer.

(2) Reimbursement to the employee is in accordance with an established written policy consistently followed by the employer.

(3) The reimbursement does not exceed the employee's actual (or reasonably estimated) expenses.

b. Allowable relocation costs for current employees are limited to the following:

(1) The costs of transportation of the employee, members of his immediate family and his household, and personal effects to the new location.

(2) The costs of finding a new home, such as advance trips by employees and spouses to locate living quarters and temporary lodging during the transition period, up to maximum period of 30 days, including advance trip time.

(3) Closing costs, such as brokerage, legal, and appraisal fees, incident to the disposition of the employee's former home. These costs, together with those described in (4), are limited to 8 per cent of the sales price of the employee's former home.

(4) The continuing costs of ownership of the vacant former home after the settlement or lease date of the employee's new permanent home, such as maintenance of buildings and grounds (exclusive of fixing up expenses), utilities, taxes, and property insurance.

(5) Other necessary and reasonable expenses normally incident to relocation, such as the costs of canceling an unexpired lease, disconnecting and reinstalling household appliances, and purchasing insurance against

loss of or damages to personal property. The cost of canceling an unexpired lease is limited to three times the monthly rental.

c. Allowable relocation costs for new employees are limited to those described in (1) and (2) of subparagraph b. When relocation costs incurred incident to the recruitment of new employees have been allowed either as a direct or indirect cost and the employee resigns for reasons within his control within 12 months after hire, the organization shall refund or credit the Federal Government for its share of the cost. However, the costs of travel to an overseas location shall be considered travel costs in accordance with paragraph 51 and not relocation costs for the purpose of this paragraph if dependents are not permitted at the location for any reason and the costs do not include costs of transporting household goods.

d. The following costs related to relocation are unallowable:

(1) Fees and other costs associated with acquiring a new home.

(2) A loss on the sale of a former home.

(3) Continuing mortgage principal and interest payments on a home being sold.

(4) Income taxes paid by an employee related to reimbursed relocation costs.

43. *Rental costs.*

a. Subject to the limitations described in subparagraphs b through d, rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and the type, life expectancy, condition, and value of the property leased.

b. Rental costs under sale and leaseback arrangements are allowable only up to the amount that would be allowed had the organization continued to own the property.

c. Rental costs under less-than-arms-length leases are allowable only up to the amount that would be allowed had title to the property vested in the organization. For this purpose, a less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between (i) divisions of an organization; (ii) organizations under common control through common officers, directors, or members; and (iii) an organization and a director, trustee, officer, or key employee of the organization or his immediate family either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.

d. Rental costs under leases which are required to be treated as capital leases under GAAP, are allowable only up to the amount that would be allowed had the organization purchased the property on the date the lease agreement was executed, i.e., to the amount that minimally would pay for depreciation or use allowances, maintenance, taxes, and insurance. Interest costs related to capitalized leases are allowable to the extent they meet criteria in subparagraph 19.a. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the organization purchased the facility.

44. *Royalties and other costs for use of patents and copyrights.*

a. Royalties on a patent or copyright or amortization of the cost of acquiring by purchase a copyright, patent, or rights thereto, necessary for the proper performance of the award are allowable unless:

(1) The Federal Government has a license or the right to free use of the patent or copyright.

(2) The patent or copyright has been adjudicated to be invalid, or has been administratively determined to be invalid.

(3) The patent or copyright is considered to be unenforceable.

(4) The patent or copyright is expired.

b. Special care should be exercised in determining reasonableness where the royalties may have arrived at as a result of less-than-arm's-length bargaining, e.g.:

(1) Royalties paid to persons, including corporations, affiliated with the organization.

(2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Federal award would be made.

(3) Royalties paid under an agreement entered into after an award is made to an organization.

c. In any case involving a patent or copyright formerly owned by the organization, the amount of royalty allowed should not exceed the cost which would have been allowed had the organization retained title thereto.

45. *Severance pay.*

a. Severance pay, also commonly referred to as dismissal wages, is a payment in addition to regular salaries and wages, by organizations to workers whose employment is being terminated. Costs of severance pay are allowable only to the extent that in each case, it is required by (i) law, (ii) employer-employee agreement, (iii) established policy that constitutes, in effect, an implied agreement on the organization's part, or (iv) circumstances of the particular employment.

b. Costs of severance payments are divided into two categories as follows:

(1) Actual normal turnover severance payments shall be allocated to all activities; or, where the organization provides for a reserve for normal severances, such method will be acceptable if the charge to current operations is reasonable in light of payments actually made for normal severances over a representative past period, and if amounts charged are allocated to all activities of the organization.

(2) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus, accruals for this purpose are not allowable. However, the Federal Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment. Thus, allowability will be considered on a case-by-case basis in the event or occurrence.

46. *Specialized service facilities.*

a. The costs of services provided by highly complex or specialized facilities operated by the organization, such as electronic computers and wind tunnels, are allowable, provided the charges for the services meet the conditions of either subparagraph b or c and, in addition, take into account any items of income or Federal financing that qualify as applicable credits under subparagraph A.5 of Attachment A.

b. The costs of such services, when material, must be charged directly to applicable awards based on actual usage of the services on the basis of a schedule of rates or established methodology that (i) does not discriminate against federally-supported activities of the organization, including usage by the organization for internal purposes, and (ii) is designed to recover only the aggregate costs of the services. The costs of each service shall consist normally of both its direct costs and its allocable share of all indirect costs. Advance agreements pursuant to subparagraph A.6 of Attachment A are particularly important in this situation.

c. Where the costs incurred for a service are not material, they may be allocated as indirect costs.

47. *Taxes.*

a. In general, taxes which the organization is required to pay and which are paid or accrued in accordance with GAAP, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable.

except for (i) Taxes from which exemptions are available to the organization directly or which are available to the organization based on an exemption afforded the Federal Government and in the latter case when the awarding agency makes available the necessary exemption certificates, (ii) special assessments on land which represent capital improvements, and (iii) Federal income taxes.

b. Any refund of taxes, and any payment to the organization of interest thereon, which were allowed as award costs, will be credited either as a cost reduction or cash refund, as appropriate, to the Federal Government.

48. *Termination costs.* Termination of awards generally give rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the award not been terminated. Cost principles covering these items are set forth below. They are to be used in conjunction with the other provisions of this Circular in termination situations.

a. *Common items.* The cost of items reasonably usable on the organization's other work shall not be allowable unless the organization submits evidence that it would not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the organization, the awarding agency should consider the organization's plans and orders for current and scheduled activity. Contemporaneous purchases of common items by the organization shall be regarded as evidence that such items are reasonably usable on the organization's other work. Any acceptance of common items as allocable to the terminated portion of the award shall be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

b. *Costs continuing after termination.* If in a particular case, despite all reasonable efforts by the organization, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this Circular, except that any such costs continuing after termination due to the negligent or willful failure of the organization to discontinue such costs shall be unallowable.

c. *Loss of useful value.* Loss of useful value of special tooling, machinery and equipment which was not charged to the award as a capital expenditure is generally allowable if:

(1) Such special tooling, machinery, or equipment is not reasonably capable of use in the other work of the organization.

(2) The interest of the Federal Government is protected by transfer of title or by other means deemed appropriate by the awarding agency;

d. *Rental costs.* Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated award less the residual value of such leases, if (i) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the award and such further period as may be reasonable, and (ii) the organization makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the award, and of reasonable restoration required by the provisions of the lease.

e. *Settlement expenses.* Settlement expenses including the following are generally allowable:

(1) Accounting, legal, clerical, and similar costs reasonably necessary for:

(a) The preparation and presentation to awarding agency of settlement claims and supporting data with respect to the terminated portion of the award, unless the termination is for default (see Sec. __.61 of Circular A-110); and

(b) The termination and settlement of subawards.

(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the Federal Government or acquired or produced for the award, except when grantees or contractors are reimbursed for disposals at a predetermined amount in accordance with Sec. __.30 through __.37 of Circular A-110.

(3) Indirect costs related to salaries and wages incurred as settlement expenses in subparagraphs (1) and (2). Normally, such indirect costs shall be limited to fringe benefits, occupancy cost, and immediate supervision.

f. *Claims under subawards.* Claims under subawards, including the allocable portion of claims which are common to the award, and to other work of the organization are generally allowable. An appropriate share of the organization's indirect expense may be allocated to the amount of settlements with subcontractors and/or subgrantees, provided that the amount allocated is otherwise consistent with the basic guidelines contained in Attachment A. The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

49. *Training and education costs.*

a. Costs of preparation and maintenance of a program of instruction including but not limited to on-the-job, classroom, and apprenticeship training, designed to increase the vocational effectiveness of employees, including training materials, textbooks, salaries or wages of trainees (excluding overtime compensation which might arise therefrom), and (i) salaries of the director of training and staff when the training program is conducted by the organization; or (ii) tuition and fees when the training is in an institution not operated by the organization, are allowable.

b. Costs of part-time education, at an undergraduate or post-graduate college level, including that provided at the organization's own facilities, are allowable only when the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work, and are limited to:

(1) Training materials.

(2) Textbooks.

(3) Fees charges by the educational institution.

(4) Tuition charged by the educational institution or, in lieu of tuition, instructors' salaries and the related share of indirect costs of the educational institution to the extent that the sum thereof is not in excess of the tuition which would have been paid to the participating educational institution.

(5) Salaries and related costs of instructors who are employees of the organization.

(6) Straight-time compensation of each employee for time spent attending classes during working hours not in excess of 156 hours per year and only to the extent that circumstances do not permit the operation of classes or attendance at classes after regular working hours; otherwise, such compensation is unallowable.

c. Costs of tuition, fees, training materials, and textbooks (but not subsistence, salary, or any other emoluments) in connection with full-time education, including that provided at the organization's own facilities, at a post-graduate (but not undergraduate) college level, are allowable only when the course or degree pursued is related to the field in which the employee is now working or may reasonably be expected to work, and only where the costs receive the prior approval of

the awarding agency. Such costs are limited to the costs attributable to a total period not to exceed one school year for each employee so trained. In unusual cases the period may be extended.

d. Costs of attendance of up to 16 weeks per employee per year at specialized programs specifically designed to enhance the effectiveness of executives or managers or to prepare employees for such positions are allowable. Such costs include enrollment fees, training materials, textbooks and related charges, employees' salaries, subsistence, and travel. Costs allowable under this paragraph do not include those for courses that are part of a degree-oriented curriculum, which are allowable only to the extent set forth in subparagraphs b and c.

e. Maintenance expense, and normal depreciation or fair rental, on facilities owned or leased by the organization for training purposes are allowable to the extent set forth in paragraphs 9, 23, and 43.

f. Contributions or donations to educational or training institutions, including the donation of facilities or other properties, and scholarships or fellowships, are unallowable.

g. Training and education costs in excess of those otherwise allowable under subparagraphs b and c may be allowed with prior approval of the awarding agency. To be considered for approval, the organization must demonstrate that such costs are consistently incurred pursuant to an established training and education program, and that the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work.

50. *Transportation costs.* Transportation costs include freight, express, cartage, and postage charges relating either to goods purchased, in process, or delivered. These costs are allowable. When such costs can readily be identified with the items involved, they may be directly charged as transportation costs or added to the cost of such items (see paragraph 24). Where identification with the materials received cannot readily be made, transportation costs may be charged to the appropriate indirect cost accounts if the organization follows a consistent, equitable procedure in this respect.

51. *Travel costs.*

a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the organization. Travel costs are allowable subject to subparagraphs b through e, when they are directly attributable to specific work under an award or are incurred in the normal course of administration of the organization.

b. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used results in charges consistent with those normally allowed by the organization in its regular operations.

c. The difference in cost between first-class air accommodations and less than first-class air accommodations is unallowable except when less than first-class air accommodations are not reasonably available to meet necessary mission requirements, such as where less than first-class accommodations would (i) require circuitous routing, (ii) require travel during unreasonable hours, (iii) greatly increase the duration of the flight, (iv) result in additional costs which would offset the transportation savings, or (v) offer accommodations which are not reasonably adequate for the medical needs of the traveler.

d. Necessary and reasonable costs of family movements and personnel movements of a special or mass nature are allowable, pursuant to paragraphs 41 and 42, subject to allocation on the basis of work or time period benefited when appropriate. Advance agreements are particularly important.

e. Direct charges for foreign travel costs are allowable only when the travel has received prior approval of the awarding agency. Each separate foreign trip must be approved. For purposes of this provision, foreign travel is defined as any travel outside of Canada and the United States and its territories and possessions. However, for an organization located in foreign countries, the term "foreign travel" means travel outside that country.

Attachment C—Non-Profit Organizations Not Subject to This Circular

Aerospace Corporation, El Segundo, California

Argonne Universities Association, Chicago, Illinois

Associated Universities, Incorporated, Washington, D.C.

Associated Universities for Research and Astronomy, Tucson, Arizona

Atomic Casualty Commission, Washington, D.C.

Battelle Memorial Institute, Headquartered in Columbus, Ohio

Brookhaven National Laboratory, Upton, New York

Center for Energy and Environmental Research (CEER), (University of Puerto Rico), Commonwealth of Puerto Rico

Charles Stark Draper Laboratory, Incorporated, Cambridge, Massachusetts

Comparative Animal Research Laboratory (CARL), (University of Tennessee), Oak Ridge, Tennessee

Environmental Institute of Michigan, Ann Arbor, Michigan

Hanford Environmental Health Foundation, Richland, Washington

IIT Research Institute, Chicago, Illinois

Institute for Defense Analysis, Arlington, Virginia

Institute of Gas Technology, Chicago, Illinois

Midwest Research Institute, Headquartered in Kansas City, Missouri

Mitre Corporation, Bedford, Massachusetts

Montana Energy Research and Development Institute, Inc. (MERDI), Butte, Montana

National Radiological Astronomy Observatory, Green Bank, West Virginia

Oak Ridge Associated Universities, Oak Ridge, Tennessee

Project Management Corporation, Oak Ridge, Tennessee

Rand Corporation, Santa Monica, California

Research Triangle Institute, Research Triangle Park, North Carolina

Riverside Research Institute, New York, New York

Sandia Corporation, Albuquerque, New Mexico

Southern Research Institute, Birmingham, Alabama

Southwest Research Institute, San Antonio, Texas

SRI International, Menlo Park, California

Syracuse Research Corporation, Syracuse, New York

Universities Research Association, Incorporated (National Acceleration Lab), Argonne, Illinois

Universities Corporation for Atmospheric Research, Boulder, Colorado

Non-profit insurance companies, such as Blue Cross and Blue Shield Organizations

Other non-profit organizations as negotiated with awarding agencies

Office of Management and Budget Circular A-110 (8/29/97)

OFFICE OF MANAGEMENT AND BUDGET (OMB)

Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals and Other Non-Profit Organizations

EDITOR'S NOTE: This circular is effective for federal agencies Dec. 29, 1993; its effective date for grantees and other organizations varies. See ¶314 of the Handbook *for details on federal agencies' implementations of Circular A-110.*

AGENCY: Office of Management and Budget.

ACTION: Final Revision to OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals and Other Non-Profit Organizations."

SUMMARY: Office of Management and Budget (OMB) Circular A-110 provides standards for obtaining consistency and uniformity among Federal agencies in the administration of grants and agreements with institutions of higher education, hospitals, and other non-profit organizations.

OMB issued Circular A-110 in 1976 and, except for a minor revision in February 1987, the Circular contains its original provisions. To update the Circular, OMB established an interagency task force to review the Circular. The task force solicited suggestions for changes to the Circular from university groups, non-profit organizations and other interested parties and compared, for consistency, the provisions of similar provisions applied to State and local governments. The revised Circular reflects the results of these efforts.

DATES: Provisions that affect Federal agencies are effective December 29, 1993. Provisions that affect grantees will be adopted by agencies in codified regulations by May 30, 1994. Earlier implementation is encouraged.

ADDRESSES: Office of Management and Budget, Office of Federal Financial Management, Financial Standards and Reporting Branch, room 10235, New Executive Office Building, Washington, DC 20503. For a copy of this Circular, contact Office of Administration, Publication Office, room 2200, New Executive Office Building, Washington, DC 20503, or telephone (202) 395-7332.

FOR FURTHER INFORMATION CONTACT: Palmer Marcantonio, Financial Standards and Reporting Branch, Office of Federal Financial Management, Office of Management and Budget (telephone: 202-395-3993).

Circular No. A-110 Revised

To the Heads of Executive Departments and Establishments

Subject: Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations

1. *Purpose*. This Circular sets forth standards for obtaining consistency and uniformity among Federal agencies in the administration of grants to and agreements with institutions of higher education, hospitals, and other non-profit organizations.

2. *Authority*. Circular A-110 is issued under the authority of 31 U.S.C. 503 (the Chief Financial Officers Act), 31 U.S.C. 1111, 41 U.S.C. 405 (the Office of Federal Procurement Policy Act), Reorganization Plan No. 2 of 1970, and E.O. 11541 ("Prescribing the Duties of the Office of Management and Budget and the Domestic Policy Council in the Executive Office of the President").

3. *Policy*. Except as provided herein, the standards set forth in this Circular are applicable to all Federal agencies. If any statute specifically prescribes policies or specific requirements that differ from the standards provided herein, the provisions of the statute shall govern.

The provisions of the sections of this Circular shall be applied by Federal agencies to recipients. Recipients shall apply the provisions of this Circular to subrecipients performing substantive work under grants and agreements that are passed through or awarded by the primary recipient, if such subrecipients are organizations described in paragraph 1.

This Circular does not apply to grants, contracts, or other agreements between the Federal Government and units of State or local governments covered by OMB Circular A-102, "Grants and Cooperative Agreements with State and Local Governments," and the Federal agencies' grants management common rule which standardized and codified the administrative requirements Federal agencies impose on State and local grantees. In addition, subawards and contracts to State or local governments are not covered by this Circular. However, this Circular applies to subawards made by State and local governments to organizations covered by this Circular. Federal agencies may apply the provisions of this Circular to commercial organizations, foreign governments, organizations under the jurisdiction of foreign governments, and international organizations.

4. *Definitions*. Definitions of key terms used in this Circular are contained in §___.2 in the Attachment.

5. *Required Action*. The specific requirements and responsibilities of Federal agencies and institutions of higher education, hospitals, and other non-profit organizations are set forth in this Circular. Federal agencies responsible for awarding and administering grants to and other agreements with organizations described in paragraph 1 shall adopt the language in the Circular unless different provisions are required by Federal statute or are approved by OMB.

6. *OMB Responsibilities*. OMB will review agency regulations and implementation of this Circular, and will provide interpretations of policy requirements and assistance to insure effective and efficient implementation. Any exceptions will be subject to approval by OMB, as indicated in §___.4 in the Attachment. Exceptions will only be made in particular cases where adequate justification is presented.

7. *Information Contact*. Further information concerning this Circular may be obtained by contacting the Office of Federal Financial Management, Office of Management and Budget, Washington, DC 20503, Telephone (202) 395-3993.

8. *Termination Review Date*. This Circular will have a policy review three years from date of issuance.

9. *Effective Date*. The standards set forth in this Circular which affect Federal agencies will be effective 30 days after publication of the final revision in the *Federal Register*. Those standards which Federal agencies impose on grantees will be adopted by agencies in codified regulations within six months after publication in the *Federal Register*. Earlier implementation is encouraged.

Leon E. Panetta,
Director.

Grants and Agreements With Institutions of Higher Education, Hospitals and Other Non-Profit Organizations

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Appendix A — Contract Provisions

Subpart A — General

§___.1 Purpose.

This Circular establishes uniform administrative requirements for Federal grants and agreements awarded to institutions of higher education, hospitals, and other non-profit organizations. Federal awarding agencies shall not impose additional or inconsistent requirements, except as provided in §___.4 and §___.14 or unless specifically required by Federal statute or executive order. Non-profit organizations that implement Federal programs for the States are also subject to State requirements.

§___.2 Definitions.

(a) *Accrued expenditures* means the charges incurred by the recipient during a given period requiring the provision of funds for: (1) Goods and other tangible property received; (2) services performed by employees, contractors, subrecipients, and other payees; and, (3) other amounts becoming owed under programs for which no current services or performance is required.

(b) *Accrued income* means the sum of: (1) Earnings during a given period from (i) services performed by the recipient, and (ii) goods and other tangible property delivered to purchasers, and (2) amounts becoming owed to the recipient for which no current services or performance is required by the recipient.

(c) *Acquisition cost of equipment* means the net invoice price of the equipment, including the cost of modifications, attachments, accessories, or auxiliary apparatus necessary to make the property usable for the purpose for which it was acquired. Other charges, such as the cost of installation, transportation, taxes, duty or protective in-transit insurance, shall be included or excluded from the unit acquisition cost in accordance with the recipient's regular accounting practices.

(d) *Advance* means a payment made by Treasury check or other appropriate payment mechanism to a recipient upon its request either before outlays are made by the recipient or through the use of predetermined payment schedules.

(e) *Award* means financial assistance that provides support or stimulation to accomplish a public purpose. Awards include grants and other agreements in the form of money or property in lieu of money, by the Federal Government to an eligible recipient. The term does not include: technical assistance, which provides services instead of money; other assistance in the form of loans, loan guarantees, interest subsidies, or insurance; direct payments of any kind to individuals; and, contracts which are required to be entered into and administered under procurement laws and regulations.

(f) *Cash contributions* means the recipient's cash outlay, including the outlay of money contributed to the recipient by third parties.

(g) *Closeout* means the process by which a Federal awarding agency determines that all applicable administrative actions and all required work of the award have been completed by the recipient and Federal awarding agency.

(h) *Contract* means a procurement contract under an award or subaward, and a procurement subcontract under a recipient's or subrecipient's contract.

(i) *Cost sharing or matching* means that portion of project or program costs not borne by the Federal Government.

(j) *Date of completion* means the date on which all work under an award is completed or the date on the award document, or any supplement or amendment thereto, on which Federal sponsorship ends.

(k) *Disallowed costs* means those charges to an award that the Federal awarding agency determines to be unallowable, in accordance with the applicable Federal cost

principles or other terms and conditions contained in the award.

(l) *Equipment* means tangible nonexpendable personal property including exempt property charged directly to the award having a useful life of more than one year and an acquisition cost of $5,000 or more per unit. However, consistent with recipient policy, lower limits may be established.

(m) *Excess property* means property under the control of any Federal awarding agency that, as determined by the head thereof, is no longer required for its needs or the discharge of its responsibilities.

(n) *Exempt property* means tangible personal property acquired in whole or in part with Federal funds, where the Federal awarding agency has statutory authority to vest title in the recipient without further obligation to the Federal Government. An example of exempt property authority is contained in the Federal Grant and Cooperative Agreement Act (31 U.S.C. 6306), for property acquired under an award to conduct basic or applied research by a nonprofit institution of higher education or non-profit organization whose principal purpose is conducting scientific research.

(o) *Federal awarding agency* means the Federal agency that provides an award to the recipient.

(p) *Federal funds authorized* means the total amount of Federal funds obligated by the Federal Government for use by the recipient. This amount may include any authorized carryover of unobligated funds from prior funding periods when permitted by agency regulations or agency implementing instructions.

(q) *Federal share of real property, equipment, or supplies* means that percentage of the property's acquisition costs and any improvement expenditures paid with Federal funds.

(r) *Funding period* means the period of time when Federal funding is available for obligation by the recipient.

(s) *Intangible property and debt instruments* means, but is not limited to, trademarks, copyrights, patents and patent applications and such property as loans, notes and other debt instruments, lease agreements, stock and other instruments of property ownership, whether considered tangible or intangible.

(t) *Obligations* means the amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period that require payment by the recipient during the same or a future period.

(u) *Outlays or expenditures* means charges made to the project or program. They may be reported on a cash or accrual basis. For reports prepared on a cash basis, outlays are the sum of cash disbursements for direct charges for goods and services, the amount of indirect expense charged, the value of third party in-kind contributions applied and the amount of cash advances and payments made to subrecipients. For reports prepared on an accrual basis, outlays are the sum of cash disbursements for direct charges for goods and services, the amount of indirect expense incurred, the value of in-kind contributions applied, and the net increase (or decrease) in the amounts owed by the recipient for goods and other property received, for services performed by employees, contractors, subrecipients and other payees and other amounts becoming owed under programs for which no current services or performance are required.

(v) *Personal property* means property of any kind except real property. It may be tangible, having physical existence, or intangible, having no physical existence, such as copyrights, patents, or securities.

(w) *Prior approval* means written approval by an authorized official evidencing prior consent.

(x) *Program income* means gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award (see exclusions in paragraphs §___.24 (e) and (h)). Program income includes, but is not limited to, income from fees for services performed, the use or rental of real or personal property acquired under federally-funded projects, the sale of commodities or items fabricated under an award, license fees and royalties on patents and copyrights, and interest on loans made with award funds. Interest earned on advances of Federal funds is not program income. Except as otherwise provided in Federal awarding agency regulations or the terms and conditions of the award, program income does not include the receipt of principal on loans, rebates, credits, discounts, etc., or interest earned on any of them.

(y) *Project costs* means all allowable costs, as set forth in the applicable Federal cost principles, incurred by a recipient and the value of the contributions made by third parties in accomplishing the objectives of the award during the project period.

(z) *Project period* means the period established in the award document during which Federal sponsorship begins and ends.

(aa) *Property* means, unless otherwise stated, real property, equipment, intangible property and debt instruments.

(bb) *Real property* means land, including land improvements, structures and appurtenances thereto, but excludes movable machinery and equipment.

(cc) *Recipient* means an organization receiving financial assistance directly from Federal awarding agencies to carry out a project or program. The term includes public and private institutions of higher education, public and private hospitals, and other quasi-public and private non-profit organizations such as, but not limited to, community action agencies, research institutes, educational associations, and health centers. The term may include commercial organizations, foreign or international organizations (such as agencies of the United Nations) which are recipients, subrecipients, or contractors or subcontractors of recipients or subrecipients at the discretion of the Federal awarding agency. The term does not include government-owned contractor-operated facilities or research centers providing continued support for mission-oriented, large-scale programs that are government-owned or controlled, or are designated as federally-funded research and development centers.

(dd) *Research and development* means all research activities, both basic and applied, and all development activities that are supported at universities, colleges, and other non-profit institutions. "Research" is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. "Development" is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes. The term research also includes activities involving the training of individuals in research techniques where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function.

(ee) *Small awards* means a grant or cooperative agreement not exceeding the small purchase threshold fixed at 41 U.S.C. 403(11) (currently $25,000).

(ff) *Subaward* means an award of financial assistance in the form of money, or property in lieu of money, made under an award by a recipient to an eligible subrecipient or by a subrecipient to a lower tier subrecipient. The term includes financial

assistance when provided by any legal agreement, even if the agreement is called a contract, but does not include procurement of goods and services nor does it include any form of assistance which is excluded from the definition of "award" in paragraph ___(e).

(gg) *Subrecipient* means the legal entity to which a subaward is made and which is accountable to the recipient for the use of the funds provided. The term may include foreign or international organizations (such as agencies of the United Nations) at the discretion of the Federal awarding agency.

(hh) *Supplies* means all personal property excluding equipment, intangible property, and debt instruments as defined in this section, and inventions of a contractor conceived or first actually reduced to practice in the performance of work under a funding agreement ("subject inventions"), as defined in 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts, and Cooperative Agreements."

(ii) *Suspension* means an action by a Federal awarding agency that temporarily withdraws Federal sponsorship under an award, pending corrective action by the recipient or pending a decision to terminate the award by the Federal awarding agency. Suspension of an award is a separate action from suspension under Federal agency regulations implementing E.O.s 12549 and 12689, "Debarment and Suspension."

(jj) *Termination* means the cancellation of Federal sponsorship, in whole or in part, under an agreement at any time prior to the date of completion.

(kk) *Third party in-kind contributions* means the value of non-cash contributions provided by non-Federal third parties. Third party in-kind contributions may be in the form of real property, equipment, supplies and other expendable property, and the value of goods and services directly benefiting and specifically identifiable to the project or program.

(ll) *Unliquidated obligations*, for financial reports prepared on a cash basis, means the amount of obligations incurred by the recipient that have not been paid. For reports prepared on an accrued expenditure basis, they represent the amount of obligations incurred by the recipient for which an outlay has not been recorded.

(mm) *Unobligated balance* means the portion of the funds authorized by the Federal awarding agency that has not been obligated by the recipient and is determined by deducting the cumulative obligations from the cumulative funds authorized.

(nn) *Unrecovered indirect cost* means the difference between the amount awarded and the amount which could have been awarded under the recipient's approved negotiated indirect cost rate.

(oo) *Working capital advance* means a procedure where by funds are advanced to the recipient to cover its estimated disbursement needs for a given initial period.

§___.3 Effect on other issuances.

For awards subject to this Circular, all administrative requirements of codified program regulations, program manuals, handbooks and other nonregulatory materials which are inconsistent with the requirements of this Circular shall be superseded, except to the extent they are required by statute, or authorized in accordance with the deviations provision in §___.4.

§___.4 Deviations.

The Office of Management and Budget (OMB) may grant exceptions for classes of grants or recipients subject to the requirements of this Circular when exceptions are not prohibited by statute. However, in the interest of maximum uniformity, exceptions from the requirements of this Circular shall be permitted only in unusual circumstances. Federal awarding agencies may apply more restrictive requirements to a class of recipients when approved by OMB. Federal awarding agencies may apply less restrictive requirements when awarding small awards, except for those requirements which are statutory. Exceptions on a case-by-case basis may also be made by Federal awarding agencies.

§___.5 Subawards.

Unless sections of this Circular specifically exclude subrecipients from coverage, the provisions of this Circular shall be applied to subrecipients performing work under awards if such subrecipients are institutions of higher education, hospitals or other non-profit organizations. State and local government subrecipients are subject to the provisions of regulations implementing the grants management common rule, "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments," published at 53 FR 8034 (3/11/88).

Subpart B — Pre-Award Requirements

§___.10 Purpose.

§§___.11 through ___.17 prescribes forms and instructions and other pre-award matters to be used in applying for Federal awards.

§___.11 Pre-award policies.

(a) Use of Grants and Cooperative Agreements, and Contracts. In each instance, the Federal awarding agency shall decide on the appropriate award instrument (i.e., grant, cooperative agreement, or contract). The Federal Grant and Cooperative Agreement Act (31 U.S.C. 6301-08) governs the use of grants, cooperative agreements and contracts. A grant or cooperative agreement shall be used only when the principal purpose of a transaction is to accomplish a public purpose of support or stimulation authorized by Federal statute. The statutory criterion for choosing between grants and cooperative agreements is that for the latter, "substantial involvement is expected between the executive agency and the State, local government, or other recipient when carrying out the activity contemplated in the agreement." Contracts shall be used when the principal purpose is acquisition of property or services for the direct benefit or use of the Federal Government.

(b) Public Notice and Priority Setting. Federal awarding agencies shall notify the public of its intended funding priorities for discretionary grant programs, unless funding priorities are established by Federal statute.

§___.12 Forms for applying for federal assistance.

(a) Federal awarding agencies shall comply with the applicable report clearance requirements of 5 CFR part 1320, "Controlling Paperwork Burdens on the Public," with regard to all forms used by the Federal awarding agency in place of or as a supplement to the Standard Form 424 (SF-424) series.

(b) Applicants shall use the SF-424 series or those forms and instructions prescribed by the Federal awarding agency.

(c) For Federal programs covered by E.O. 12372, "Intergovernmental Review of Federal Programs," the applicant shall complete the appropriate sections of the SF-424 (Application for Federal Assistance) indicating whether the application was subject to review by the State Single Point of Contact (SPOC). The name and address of the SPOC for a particular State can be obtained

from the Federal awarding agency or the *Catalog of Federal Domestic Assistance*. The SPOC shall advise the applicant whether the program for which application is made has been selected by that State for review.

(d) Federal awarding agencies that do not use the SF-424 form should indicate whether the application is subject to review by the State under E.O. 12372.

§___.13 Debarment and suspension.

Federal awarding agencies and recipients shall comply with the nonprocurement debarment and suspension common rule implementing E.O.s 12549 and 12689, "Debarment and Suspension." This common rule restricts subawards and contracts with certain parties that are debarred, suspended or otherwise excluded from or ineligible for participation in Federal assistance programs or activities.

§___.14 Special award conditions.

If an applicant or recipient: (a) has a history of poor performance, (b) is not financially stable, (c) has a management system that does not meet the standards prescribed in this Circular, (d) has not conformed to the terms and conditions of a previous award, or (e) is not otherwise responsible, Federal awarding agencies may impose additional requirements as needed, provided that such applicant or recipient is notified in writing as to: the nature of the additional requirements, the reason why the additional requirements are being imposed, the nature of the corrective action needed, the time allowed for completing the corrective actions, and the method for requesting reconsideration of the additional requirements imposed. Any special conditions shall be promptly removed once the conditions that prompted them have been corrected.

§___.15 Metric system of measurement.

The Metric Conversion Act, as amended by the Omnibus Trade and Competitiveness Act (15 U.S.C. 205) declares that the metric system is the preferred measurement system for U.S. trade and commerce. The Act requires each Federal agency to establish a date or dates in consultation with the Secretary of Commerce, when the metric system of measurement will be used in the agency's procurements, grants, and other business-related activities. Metric implementation may take longer where the use of the system is initially impractical or likely to cause significant inefficiencies in the accomplishment of federally-funded activities. Federal awarding agencies shall follow the provisions of E.O. 12770, "Metric Usage in Federal Government Programs."

§___.16 Resource Conservation and Recovery Act.

Under the Act, any State agency or agency of a political subdivision of a State which is using appropriated Federal funds must comply with Section 6002. Section 6002 requires that preference be given in procurement programs to the purchase of specific products containing recycled materials identified in guidelines developed by the Environmental Protection Agency (EPA) (40 CFR parts 247-254). Accordingly, State and local institutions of higher education, hospitals, and non-profit organizations that receive direct Federal awards or other Federal funds shall give preference in their procurement programs funded with Federal funds to the purchase of recycled products pursuant to the EPA guidelines.

§___.17 Certifications and representations.

Unless prohibited by statute or codified regulation, each Federal awarding agency is authorized and encouraged to allow recipients to submit certifications and representations required by statute, executive order, or regulation on an annual basis, if the recipients have ongoing and continuing relationships with the agency. Annual certifications and representations shall be signed by responsible officials with the authority to ensure recipients' compliance with the pertinent requirements.

Subpart C — Post-Award Requirements

Financial and Program Management

§___.20 Purpose of financial and program management.

§§___.21 through ___.28 prescribe standards for financial management systems, methods for making payments and rules for: satisfying cost sharing and matching requirements, accounting for program income, budget revision approvals, making audits, determining allowability of cost, and establishing fund availability.

§___.21 Standards for financial management systems.

(a) Federal awarding agencies shall require recipients to relate financial data to performance data and develop unit cost information whenever practical.

(b) Recipients' financial management systems shall provide for the following.

(1) Accurate, current and complete disclosure of the financial results of each federally-sponsored project or program in accordance with the reporting requirements set forth in §___.52. If a Federal awarding agency requires reporting on an accrual basis from a recipient that maintains its records on other than an accrual basis, the recipient shall not be required to establish an accrual accounting system. These recipients may develop such accrual data for its reports on the basis of an analysis of the documentation on hand.

(2) Records that identify adequately the source and application of funds for federally-sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income and interest.

(3) Effective control over and accountability for all funds, property and other assets. Recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes.

(4) Comparison of outlays with budget amounts for each award. Whenever appropriate, financial information should be related to performance and unit cost data.

(5) Written procedures to minimize the time elapsing between the transfer of funds to the recipient from the U.S. Treasury and the issuance or redemption of checks, warrants or payments by other means for program purposes by the recipient. To the extent that the provisions of the Cash Management Improvement Act (CMIA) (Pub. L. 101-453) govern, payment methods of State agencies, instrumentalities, and fiscal agents shall be consistent with CMIA Treasury-State Agreements or the CMIA default procedures codified at 31 CFR part 205, "Withdrawal of Cash from the Treasury for Advances under Federal Grant and Other Programs."

(6) Written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.

(7) Accounting records including cost accounting records that are supported by source documentation.

(c) Where the Federal Government guarantees or insures the repayment of money borrowed by the recipient, the Federal awarding agency, at its discretion, may

require adequate bonding and insurance if the bonding and insurance requirements of the recipient are not deemed adequate to protect the interest of the Federal Government.

(d) The Federal awarding agency may require adequate fidelity bond coverage where the recipient lacks sufficient coverage to protect the Federal Government's interest.

(e) Where bonds are required in the situations described above, the bonds shall be obtained from companies holding certificates of authority as acceptable sureties, as prescribed in 31 CFR part 223, "Surety Companies Doing Business with the United States."

§___.22 Payment.

(a) Payment methods shall minimize the time elapsing between the transfer of funds from the United States Treasury and the issuance or redemption of checks, warrants, or payment by other means by the recipients. Payment methods of State agencies or instrumentalities shall be consistent with Treasury-State CMIA agreements or default procedures codified at 31 CFR part 205.

(b) Recipients are to be paid in advance, provided they maintain or demonstrate the willingness to maintain: (1) written procedures that minimize the time elapsing between the transfer of funds and disbursement by the recipient, and (2) financial management systems that meet the standards for fund control and accountability as established in §___.21. Cash advances to a recipient organization shall be limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program or project costs and the proportionate share of any allowable indirect costs.

(c) Whenever possible, advances shall be consolidated to cover anticipated cash needs for all awards made by the Federal awarding agency to the recipient.

(1) Advance payment mechanisms include, but are not limited to, Treasury check and electronic funds transfer.

(2) Advance payment mechanisms are subject to 31 CFR part 205.

(3) Recipients shall be authorized to submit a requests for advances and reimbursements at least monthly when electronic fund transfers are not used.

(d) Requests for Treasury check advance payment shall be submitted on SF-270, "Request for Advance or Reimbursement," or other forms as may be authorized by OMB. This form is not to be used when Treasury check advance payments are made to the recipient automatically through the use of a predetermined payment schedule or if precluded by special Federal awarding agency instructions for electronic funds transfer.

(e) Reimbursement is the preferred method when the requirements in paragraph (b) cannot be met. Federal awarding agencies may also use this method on any construction agreement, or if the major portion of the construction project is accomplished through private market financing or Federal loans, and the Federal assistance constitutes a minor portion of the project.

(1) When the reimbursement method is used, the Federal awarding agency shall make payment within 30 days after receipt of the billing, unless the billing is improper.

(2) Recipients shall be authorized to submit a request for reimbursement at least monthly when electronic funds transfers are not used.

(f) If a recipient cannot meet the criteria for advance payments and the Federal awarding agency has determined that reimbursement is not feasible because the recipient lacks sufficient working capital, the Federal awarding agency may provide cash on a working capital advance basis. Under this procedure, the Federal awarding agency shall advance cash to the recipient to cover its estimated disbursement needs for an initial period generally geared to the awardee's disbursing cycle. Thereafter, the Federal awarding agency shall reimburse the recipient for its actual cash disbursements. The working capital advance method of payment shall not be used for recipients unwilling or unable to provide timely advances to their subrecipient to meet the subrecipient's actual cash disbursements.

(g) To the extent available, recipients shall disburse funds available from repayments to and interest earned on a revolving fund, program income, rebates, refunds, contract settlements, audit recoveries and interest earned on such funds before requesting additional cash payments.

(h) Unless otherwise required by statute, Federal awarding agencies shall not withhold payments for proper charges made by recipients at any time during the project period unless (1) or (2) apply.

(1) A recipient has failed to comply with the project objectives, the terms and conditions of the award, or Federal reporting requirements.

(2) The recipient or subrecipient is delinquent in a debt to the United States as defined in OMB Circular A-129, "Managing Federal Credit Programs." Under such conditions, the Federal awarding agency may, upon reasonable notice, inform the recipient that payments shall not be made for obligations incurred after a specified date until the conditions are corrected or the indebtedness to the Federal Government is liquidated.

(i) Standards governing the use of banks and other institutions as depositories of funds advanced under awards are as follows.

(1) Except for situations described in paragraph (i)(2), Federal awarding agencies shall not require separate depository accounts for funds provided to a recipient or establish any eligibility requirements for depositories for funds provided to a recipient. However, recipients must be able to account for the receipt, obligation and expenditure of funds.

(2) Advances of Federal funds shall be deposited and maintained in insured accounts whenever possible.

(j) Consistent with the national goal of expanding the opportunities for women-owned and minority-owned business enterprises, recipients shall be encouraged to use women-owned and minority-owned banks (a bank which is owned at least 50 percent by women or minority group members).

(k) Recipients shall maintain advances of Federal funds in interest bearing accounts, unless (1), (2) or (3) apply.

(1) The recipient receives less than $120,000 in Federal awards per year.

(2) The best reasonably available interest bearing account would not be expected to earn interest in excess of $250 per year on Federal cash balances.

(3) The depository would require an average or minimum balance so high that it would not be feasible within the expected Federal and non-Federal cash resources.

(l) For those entities where CMIA and its implementing regulations do not apply, interest earned on Federal advances deposited in interest bearing accounts shall be remitted annually to Department of Health and Human Services, Payment Management System, Rockville, MD 20852. Interest amounts up to $250 per year may be retained by the recipient for administrative expense. State universities and hospitals shall comply with CMIA, as it pertains to interest. If an entity subject to CMIA uses its own funds to pay pre-award costs for

discretionary awards without prior written approval from the Federal awarding agency, it waives its right to recover the interest under CMIA.

(m) Except as noted elsewhere in this Circular, only the following forms shall be authorized for the recipients in requesting advances and reimbursements. Federal agencies shall not require more than an original and two copies of these forms.

(1) SF-270, Request for Advance or Reimbursement. Each Federal awarding agency shall adopt the SF-270 as a standard form for all nonconstruction programs when electronic funds transfer or predetermined advance methods are not used. Federal awarding agencies, however, have the option of using this form for construction programs in lieu of the SF-271, "Outlay Report and Request for Reimbursement for Construction Programs."

(2) SF-271, Outlay Report and Request for Reimbursement for Construction Programs. Each Federal awarding agency shall adopt the SF-271 as the standard form to be used for requesting reimbursement for construction programs. However, a Federal awarding agency may substitute the SF-270 when the Federal awarding agency determines that it provides adequate information to meet Federal needs.

§___.23 Cost sharing or matching.

(a) All contributions, including cash and third party in-kind, shall be accepted as part of the recipient's cost sharing or matching when such contributions meet all of the following criteria.

(1) Are verifiable from the recipient's records.

(2) Are not included as contributions for any other federally-assisted project or program.

(3) Are necessary and reasonable for proper and efficient accomplishment of project or program objectives.

(4) Are allowable under the applicable cost principles.

(5) Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching.

(6) Are provided for in the approved budget when required by the Federal awarding agency.

(7) Conform to other provisions of this Circular, as applicable.

(b) Unrecovered indirect costs may be included as part of cost sharing or matching only with the prior approval of the Federal awarding agency.

(c) Values for recipient contributions of services and property shall be established in accordance with the applicable cost principles. If a Federal awarding agency authorizes recipients to donate buildings or land for construction/facilities acquisition projects or long-term use, the value of the donated property for cost sharing or matching shall be the lesser of (1) or (2).

(1) The certified value of the remaining life of the property recorded in the recipient's accounting records at the time of donation.

(2) The current fair market value. However, when there is sufficient justification, the Federal awarding agency may approve the use of the current fair market value of the donated property, even if it exceeds the certified value at the time of donation to the project.

(d) Volunteer services furnished by professional and technical personnel, consultants, and other skilled and unskilled labor may be counted as cost sharing or matching if the service is an integral and necessary part of an approved project or program. Rates for volunteer services shall be consistent with those paid for similar work in the recipient's organization. In those instances in which the required skills are not found in the recipient organization, rates shall be consistent with those paid for similar work in the labor market in which the recipient competes for the kind of services involved. In either case, paid fringe benefits that are reasonable, allowable, and allocable may be included in the valuation.

(e) When an employer other than the recipient furnishes the services of an employee, these services shall be valued at the employee's regular rate of pay (plus an amount of fringe benefits that are reasonable, allowable, and allocable, but exclusive of overhead costs), provided these services are in the same skill for which the employee is normally paid.

(f) Donated supplies may include such items as expendable equipment, office supplies, laboratory supplies or workshop and classroom supplies. Value assessed to donated supplies included in the cost sharing or matching share shall be reasonable and shall not exceed the fair market value of the property at the time of the donation.

(g) The method used for determining cost sharing or matching for donated equipment, buildings and land for which title passes to the recipient may differ according to the purpose of the award, if (1) or (2) apply.

(1) If the purpose of the award is to assist the recipient in the acquisition of equipment, buildings or land, the total value of the donated property may be claimed as cost sharing or matching.

(2) If the purpose of the award is to support activities that require the use of equipment, buildings or land, normally only depreciation or use charges for equipment and buildings may be made. However, the full value of equipment or other capital assets and fair rental charges for land may be allowed, provided that the Federal awarding agency has approved the charges.

(h) The value of donated property shall be determined in accordance with the usual accounting policies of the recipient, with the following qualifications.

(1) The value of donated land and buildings shall not exceed its fair market value at the time of donation to the recipient as established by an independent appraiser (e.g., certified real property appraiser or General Services Administration representative) and certified by a responsible official of the recipient.

(2) The value of donated equipment shall not exceed the fair market value of equipment of the same age and condition at the time of donation.

(3) The value of donated space shall not exceed the fair rental value of comparable space as established by an independent appraisal of comparable space and facilities in a privately-owned building in the same locality.

(4) The value of loaned equipment shall not exceed its fair rental value.

(5) The following requirements pertain to the recipient's supporting records for in-kind contributions from third parties.

(i) Volunteer services shall be documented and, to the extent feasible, supported by the same methods used by the recipient for its own employees.

(ii) The basis for determining the valuation for personal service, material, equipment, buildings and land shall be documented.

§___.24 Program income.

(a) Federal awarding agencies shall apply the standards set forth in this section in requiring recipient organizations to account for program income related to projects financed in whole or in part with Federal funds.

(b) Except as provided in paragraph (h) below, program income earned during the project period shall be retained by the recipient and, in accordance with Federal

awarding agency regulations or the terms and conditions of the award, shall be used in one or more of the ways listed in the following.

(1) Added to funds committed to the project by the Federal awarding agency and recipient and used to further eligible project or program objectives.

(2) Used to finance the non-Federal share of the project or program.

(3) Deducted from the total project or program allowable cost in determining the net allowable costs on which the Federal share of costs is based.

(c) When an agency authorizes the disposition of program income as described in paragraphs (b)(1) or (b)(2), program income in excess of any limits stipulated shall be used in accordance with paragraph (b)(3).

(d) In the event that the Federal awarding agency does not specify in its regulations or the terms and conditions of the award how program income is to be used, paragraph (b)(3) shall apply automatically to all projects or programs except research. For awards that support research, paragraph (b)(1) shall apply automatically unless the awarding agency indicates in the terms and conditions another alternative on the award or the recipient is subject to special award conditions, as indicated in §___.14.

(e) Unless Federal awarding agency regulations or the terms and conditions of the award provide otherwise, recipients shall have no obligation to the Federal Government regarding program income earned after the end of the project period.

(f) If authorized by Federal awarding agency regulations or the terms and conditions of the award, costs incident to the generation of program income may be deducted from gross income to determine program income, provided these costs have not been charged to the award.

(g) Proceeds from the sale of property shall be handled in accordance with the requirements of the Property Standards (See §§___.30 through ___.37).

(h) Unless Federal awarding agency regulations or the terms and condition of the award provide otherwise, recipients shall have no obligation to the Federal Government with respect to program income earned from license fees and royalties for copyrighted material, patents, patent applications, trademarks, and inventions produced under an award. However, Patent and Trademark Amendments (35 U.S.C. 18) apply to inventions made under an experimental, developmental, or research award.

§___.25 Revision of budget and program plans.

(a) The budget plan is the financial expression of the project or program as approved during the award process. It may include either the Federal and non-Federal share, or only the Federal share, depending upon Federal awarding agency requirements. It shall be related to performance for program evaluation purposes whenever appropriate.

(b) Recipients are required to report deviations from budget and program plans, and request prior approvals for budget and program plan revisions, in accordance with this section.

(c) For nonconstruction awards, recipients shall request prior approvals from Federal awarding agencies for one or more of the following program or budget related reasons.

(1) Change in the scope or the objective of the project or program (even if there is no associated budget revision requiring prior written approval).

(2) Change in a key person specified in the application or award document.

(3) The absence for more than three months, or a 25 percent reduction in time devoted to the project, by the approved project director or principal investigator.

(4) The need for additional Federal funding.

(5) The transfer of amounts budgeted for indirect costs to absorb increases in direct costs, or vice versa, if approval is required by the Federal awarding agency.

(6) The inclusion, unless waived by the Federal awarding agency, of costs that require prior approval in accordance with OMB Circular A-21, "Cost Principles for Institutions of Higher Education," OMB Circular A-122, "Cost Principles for Non-Profit Organizations," or 45 CFR part 74 Appendix E, "Principles for Determining Costs Applicable to Research and Development under Grants and Contracts with Hospitals," or 48 CFR part 31, "Contract Cost Principles and Procedures," as applicable.

(7) The transfer of funds allotted for training allowances (direct payment to trainees) to other categories of expense.

(8) Unless described in the application and funded in the approved awards, the subaward, transfer or contracting out of any work under an award. This provision does not apply to the purchase of supplies, material, equipment or general support services.

(d) No other prior approval requirements for specific items may be imposed unless a deviation has been approved by OMB.

(e) Except for requirements listed in paragraphs (c)(1) and (c)(4) of this section, Federal awarding agencies are authorized, at their option, to waive cost-related and administrative prior written approvals required by this Circular and OMB Circulars A-21 and A-122. Such waivers may include authorizing recipients to do any one or more of the following.

(1) Incur pre-award costs 90 calendar days prior to award or more than 90 calendar days with the prior approval of the Federal awarding agency. All pre-award costs are incurred at the recipient's risk (i.e., the Federal awarding agency is under no obligation to reimburse such costs if for any reason the recipient does not receive an award or if the award is less than anticipated and inadequate to cover such costs).

(2) Initiate a one-time extension of the expiration date of the award of up to 12 months unless one or more of the following conditions apply. For one-time extensions, the recipient must notify the Federal awarding agency in writing with the supporting reasons and revised expiration date at least 10 days before the expiration date specified in the award. This one-time extension may not be exercised merely for the purpose of using unobligated balances.

(i) The terms and conditions of award prohibit the extension.

(ii) The extension requires additional Federal funds.

(iii) The extension involves any change in the approved objectives or scope of the project.

(3) Carry forward unobligated balances to subsequent funding periods.

(4) For awards that support research, unless the Federal awarding agency provides otherwise in the award or in the agency's regulations, the prior approval requirements described in paragraph (e) are automatically waived (i.e., recipients need not obtain such prior approvals) unless one of the conditions included in paragraph (e)(2) applies.

(f) The Federal awarding agency may, at its option, restrict the transfer of funds among direct cost categories or programs, functions and activities for awards in which the Federal share of the project exceeds $100,000 and the cumulative amount of such transfers exceeds or is expected to exceed 10 percent of the total budget as last approved by the Federal awarding agency. No Federal awarding agency shall permit a transfer that would cause any Federal appropriation or part thereof to be used for

purposes other than those consistent with the original intent of the appropriation.

(g) All other changes to nonconstruction budgets, except for the changes described in paragraph (j), do not require prior approval.

(h) For construction awards, recipients shall request prior written approval promptly from Federal awarding agencies for budget revisions whenever (1), (2) or (3) apply.

(1) The revision results from changes in the scope or the objective of the project or program.

(2) The need arises for additional Federal funds to complete the project.

(3) A revision is desired which involves specific costs for which prior written approval requirements may be imposed consistent with applicable OMB cost principles listed in §___.27.

(i) No other prior approval requirements for specific items may be imposed unless a deviation has been approved by OMB.

(j) When a Federal awarding agency makes an award that provides support for both construction and nonconstruction work, the Federal awarding agency may require the recipient to request prior approval from the Federal awarding agency before making any fund or budget transfers between the two types of work supported.

(k) For both construction and nonconstruction awards, Federal awarding agencies shall require recipients to notify the Federal awarding agency in writing promptly whenever the amount of Federal authorized funds is expected to exceed the needs of the recipient for the project period by more than $5,000 or five percent of the Federal award, whichever is greater. This notification shall not be required if an application for additional funding is submitted for a continuation award.

(l) When requesting approval for budget revisions, recipients shall use the budget forms that were used in the application unless the Federal awarding agency indicates a letter of request suffices.

(m) Within 30 calendar days from the date of receipt of the request for budget revisions, Federal awarding agencies shall review the request and notify the recipient whether the budget revisions have been approved. If the revision is still under consideration at the end of 30 calendar days, the Federal awarding agency shall inform the recipient in writing of the date when the recipient may expect the decision.

***§___.26 Non-Federal audits.**

(a) Recipients and subrecipients that are institutions of higher education or other non-profit organizations (including hospitals) shall be subject to the audit requirements contained in the Single Audit Act Amendments of 1996 (31 U.S.C. 7501-7507) and revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

(b) State and local governments shall be subject to the audit requirements contained in the Single Audit Act Amendments of 1996 (31 U.S.C. 7501-7507) and revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

(c) For-profit hospitals not covered by the audit provisions of revised OMB Circular A-133 shall be subject to the audit requirements of the federal awarding agencies.

(d) Commercial organizations shall be subject to the audit requirements of the Federal awarding agency or the prime recipient as incorporated into the award document.

§___.27 Allowable costs.

For each kind of recipient, there is a set of Federal principles for determining allowable costs. Allowability of costs shall be determined in accordance with the cost principles applicable to the entity incurring the costs. Thus, allowability of costs incurred by State, local or federally-recognized Indian tribal governments is determined in accordance with the provisions of OMB Circular A-87, "Cost Principles for State and Local Governments." The allowability of costs incurred by non-profit organizations is determined in accordance with the provisions of OMB Circular A-122, "Cost Principles for Non-Profit Organizations." The allowability of costs incurred by institutions of higher education is determined in accordance with the provisions of OMB Circular A-21, "Cost Principles for Educational Institutions." The allowability of costs incurred by hospitals is determined in accordance with the provisions of Appendix E of 45 CFR part 74, "Principles for Determining Costs Applicable to Research and Development Under Grants and Contracts with Hospitals." The allowability of costs incurred by commercial organizations and those non-profit organizations listed in Attachment C to Circular A-122 is determined in accordance with the provisions of the Federal Acquisition Regulation (FAR) at 48 CFR part 31.

§___.28 Period of availability of funds.

Where a funding period is specified, a recipient may charge to the grant only allowable costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the Federal awarding agency.

****§___.29 Conditional exemptions.**

(a) OMB authorizes conditional exemption from OMB administrative requirements and cost principles circulars for certain Federal programs with statutorily-authorized consolidated planning and consolidated administrative funding, that are identified by a Federal agency and approved by the head of the Executive department or establishment. A Federal agency shall consult with OMB during its consideration of whether to grant such an exemption.

(b) To promote efficiency in State and local program administration, when Federal non-entitlement programs with common purposes have specific statutorily-authorized consolidated planning and consolidated administrative funding and where most of the State agency's resources come from non-Federal sources, Federal agencies may exempt these covered State-administered, non-entitlement grant programs from certain OMB grants management requirements. The exemptions would be from all but the allocability of costs provisions of OMB Circulars A-87 (Attachment A, subsection C.3), "Cost Principles for State, Local, and Indian Tribal Governments," A-21 (Section C, subpart 4), "Cost Principles for Educational Institutions," and A-122 (Attachment A, subsection A.4), "Cost Principles for Non-Profit Organizations," and from all of the administrative requirements provisions of OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," and the agencies' grants management common rule.

(c) When a Federal agency provides this flexibility, as a prerequisite to a State's exercising this option, a State must adopt its own written fiscal and administrative requirements for expending and accounting for all funds, which are consistent with the provisions of OMB Circular A-87, and extend such policies to all subrecipients. These fiscal and administrative requirements must be sufficiently specific to ensure that: funds are used in compliance with all

*Editor's note: This section is amended to reference revised OMB Circular A-133. See Aug. 29, 1997, *Federal Register*, pages 45934-45936.
**Editor's note: §__.29 incorporates conditional program exemption OMB has authorized. See Aug. 29, 1997, *Federal Register*, pages 45934-45936.

applicable federal statutory and regulatory provisions, costs are reasonable and necessary for operating these programs, and funds are not to be used for general expenses required to carry out other responsibilities of a State or its subrecipients.

Property Standards

§___.30 Purpose of property standards.

§§___.31 through ___.37 set forth uniform standards governing management and disposition of property furnished by the Federal Government whose cost was charged to a project supported by a Federal award. Federal awarding agencies shall require recipients to observe these standards under awards and shall not impose additional requirements, unless specifically required by Federal statute. The recipient may use its own property management standards and procedures provided it observes the provisions of §§___.31 through ___.37.

§___.31 Insurance coverage.

Recipients shall, at a minimum, provide the equivalent insurance coverage for real property and equipment acquired with Federal funds as provided to property owned by the recipient. Federally-owned property need not be insured unless required by the terms and conditions of the award.

§___.32 Real property.

Each Federal awarding agency shall prescribe requirements for recipients concerning the use and disposition of real property acquired in whole or in part under awards. Unless otherwise provided by statute, such requirements, at a minimum, shall contain the following.

(a) Title to real property shall vest in the recipient subject to the condition that the recipient shall use the real property for the authorized purpose of the project as long as it is needed and shall not encumber the property without approval of the Federal awarding agency.

(b) The recipient shall obtain written approval by the Federal awarding agency for the use of real property in other federally-sponsored projects when the recipient determines that the property is no longer needed for the purpose of the original project. Use in other projects shall be limited to those under federally-sponsored projects (i.e., awards) or programs that have purposes consistent with those authorized for support by the Federal awarding agency.

(c) When the real property is no longer needed as provided in paragraphs (a) and (b), the recipient shall request disposition instructions from the Federal awarding agency or its successor Federal awarding agency. The Federal awarding agency shall observe one or more of the following disposition instructions.

(1) The recipient may be permitted to retain title without further obligation to the Federal Government after it compensates the Federal Government for that percentage of the current fair market value of the property attributable to the Federal participation in the project.

(2) The recipient may be directed to sell the property under guidelines provided by the Federal awarding agency and pay the Federal Government for that percentage of the current fair market value of the property attributable to the Federal participation in the project (after deducting actual and reasonable selling and fix-up expenses, if any, from the sales proceeds). When the recipient is authorized or required to sell the property, proper sales procedures shall be established that provide for competition to the extent practicable and result in the highest possible return.

(3) The recipient may be directed to transfer title to the property to the Federal Government or to an eligible third party provided that, in such cases, the recipient shall be entitled to compensation for its attributable percentage of the current fair market value of the property.

§___.33 Federally-owned and exempt property.

(a) Federally-owned property.

(1) Title to federally-owned property remains vested in the Federal Government. Recipients shall submit annually an inventory listing of federally-owned property in their custody to the Federal awarding agency. Upon completion of the award or when the property is no longer needed, the recipient shall report the property to the Federal awarding agency for further Federal agency utilization.

(2) If the Federal awarding agency has no further need for the property, it shall be declared excess and reported to the General Services Administration, unless the Federal awarding agency has statutory authority to dispose of the property by alternative methods (e.g., the authority provided by the Federal Technology Transfer Act (15 U.S.C. 3710 (l)) to donate research equipment to educational and non-profit organizations in accordance with E.O. 12821, "Improving Mathematics and Science Education in Support of the National Education Goals.") Appropriate instructions shall be issued to the recipient by the Federal awarding agency.

(b) Exempt property. When statutory authority exists, the Federal awarding agency has the option to vest title to property acquired with Federal funds in the recipient without further obligation to the Federal Government and under conditions the Federal awarding agency considers appropriate. Such property is "exempt property." Should a Federal awarding agency not establish conditions, title to exempt property upon acquisition shall vest in the recipient without further obligation to the Federal Government.

§___.34 Equipment.

(a) Title to equipment acquired by a recipient with Federal funds shall vest in the recipient, subject to conditions of this section.

(b) The recipient shall not use equipment acquired with Federal funds to provide services to non-Federal outside organizations for a fee that is less than private companies charge for equivalent services, unless specifically authorized by Federal statute, for as long as the Federal Government retains an interest in the equipment.

(c) The recipient shall use the equipment in the project or program for which it was acquired as long as needed, whether or not the project or program continues to be supported by Federal funds and shall not encumber the property without approval of the Federal awarding agency. When no longer needed for the original project or program, the recipient shall use the equipment in connection with its other federally-sponsored activities, in the following order of priority: (i) Activities sponsored by the Federal awarding agency which funded the original project, then (ii) activities sponsored by other Federal awarding agencies.

(d) During the time that equipment is used on the project or program for which it was acquired, the recipient shall make it available for use on other projects or programs if such other use will not interfere with the work on the project or program for which the equipment was originally acquired. First preference for such other use shall be given to other projects or programs sponsored by the Federal awarding agency that financed the equipment; second preference shall be given to projects or programs sponsored by other Federal awarding agencies. If the equipment is owned by the Federal Government, use on other activities not

sponsored by the Federal Government shall be permissible if authorized by the Federal awarding agency. User charges shall be treated as program income.

(e) When acquiring replacement equipment, the recipient may use the equipment to be replaced as trade-in or sell the equipment and use the proceeds to offset the costs of the replacement equipment subject to the approval of the Federal awarding agency.

(f) The recipient's property management standards for equipment acquired with Federal funds and federally-owned equipment shall include all of the following.

(1) Equipment records shall be maintained accurately and shall include the following information.

(i) A description of the equipment.

(ii) Manufacturer's serial number, model number, Federal stock number, national stock number, or other identification number.

(iii) Source of the equipment, including the award number.

(iv) Whether title vests in the recipient or the Federal Government.

(v) Acquisition date (or date received, if the equipment was furnished by the Federal Government) and cost.

(vi) Information from which one can calculate the percentage of Federal participation in the cost of the equipment (not applicable to equipment furnished by the Federal Government).

(vii) Location and condition of the equipment and the date the information was reported.

(viii) Unit acquisition cost.

(ix) Ultimate disposition data, including date of disposal and sales price or the method used to determine current fair market value where a recipient compensates the Federal awarding agency for its share.

(2) Equipment owned by the Federal Government shall be identified to indicate Federal ownership.

(3) A physical inventory of equipment shall be taken and the results reconciled with the equipment records at least once every two years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference. The recipient shall, in connection with the inventory, verify the existence, current utilization, and continued need for the equipment.

(4) A control system shall be in effect to insure adequate safeguards to prevent loss, damage, or theft of the equipment. Any loss, damage, or theft of equipment shall be investigated and fully documented; if the equipment was owned by the Federal Government, the recipient shall promptly notify the Federal awarding agency.

(5) Adequate maintenance procedures shall be implemented to keep the equipment in good condition.

(6) Where the recipient is authorized or required to sell the equipment, proper sales procedures shall be established which provide for competition to the extent practicable and result in the highest possible return.

(g) When the recipient no longer needs the equipment, the equipment may be used for other activities in accordance with the following standards. For equipment with a current per unit fair market value of $5,000 or more, the recipient may retain the equipment for other uses provided that compensation is made to the original Federal awarding agency or its successor. The amount of compensation shall be computed by applying the percentage of Federal participation in the cost of the original project or program to the current fair market value of the equipment. If the recipient has no need for the equipment, the recipient shall request disposition instructions from the Federal awarding agency. The Federal awarding agency shall determine whether the equipment can be used to meet the agency's requirements. If no requirement exists within that agency, the availability of the equipment shall be reported to the General Services Administration by the Federal awarding agency to determine whether a requirement for the equipment exists in other Federal agencies. The Federal awarding agency shall issue instructions to the recipient no later than 120 calendar days after the recipient's request and the following procedures shall govern.

(1) If so instructed or if disposition instructions are not issued within 120 calendar days after the recipient's request, the recipient shall sell the equipment and reimburse the Federal awarding agency an amount computed by applying to the sales proceeds the percentage of Federal participation in the cost of the original project or program. However, the recipient shall be permitted to deduct and retain from the Federal share $500 or ten percent of the proceeds, whichever is less, for the recipient's selling and handling expenses.

(2) If the recipient is instructed to ship the equipment elsewhere, the recipient shall be reimbursed by the Federal Government by an amount which is computed by applying the percentage of the recipient's participation in the cost of the original project or program to the current fair market value of the equipment, plus any reasonable shipping or interim storage costs incurred.

(3) If the recipient is instructed to otherwise dispose of the equipment, the recipient shall be reimbursed by the Federal awarding agency for such costs incurred in its disposition.

(4) The Federal awarding agency may reserve the right to transfer the title to the Federal Government or to a third party named by the Federal Government when such third party is otherwise eligible under existing statutes. Such transfer shall be subject to the following standards.

(i) The equipment shall be appropriately identified in the award or otherwise made known to the recipient in writing.

(ii) The Federal awarding agency shall issue disposition instructions within 120 calendar days after receipt of a final inventory. The final inventory shall list all equipment acquired with grant funds and federally-owned equipment. If the Federal awarding agency fails to issue disposition instructions within the 120 calendar day period, the recipient shall apply the standards of this section, as appropriate.

(iii) When the Federal awarding agency exercises its right to take title, the equipment shall be subject to the provisions for federally-owned equipment.

§___.35 Supplies and other expendable property.

(a) Title to supplies and other expendable property shall vest in the recipient upon acquisition. If there is a residual inventory of unused supplies exceeding $5,000 in total aggregate value upon termination or completion of the project or program and the supplies are not needed for any other federally-sponsored project or program, the recipient shall retain the supplies for use on non-Federal sponsored activities or sell them, but shall, in either case, compensate the Federal Government for its share. The amount of compensation shall be computed in the same manner as for equipment.

(b) The recipient shall not use supplies acquired with Federal funds to provide services to non-Federal outside organizations for a fee that is less than private companies charge for equivalent services, unless specifically authorized by Federal statute as long as the Federal Government retains an interest in the supplies.

§___.36 Intangible property.

(a) The recipient may copyright any work that is subject to copyright and was developed, or for which ownership was purchased, under an award. The Federal awarding agency(ies) reserve a royalty-free, nonexclusive and irrevocable right to reproduce, publish, or otherwise use the work for Federal purposes, and to authorize others to do so.

(b) Recipients are subject to applicable regulations governing patents and inventions, including government-wide regulations issued by the Department of Commerce at 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements."

(c) Unless waived by the Federal awarding agency, the Federal Government has the right to (1) and (2).

(1) Obtain, reproduce, publish or otherwise use the data first produced under an award.

(2) Authorize others to receive, reproduce, publish, or otherwise use such data for Federal purposes.

(d) Title to intangible property and debt instruments acquired under an award or subaward vests upon acquisition in the recipient. The recipient shall use that property for the originally-authorized purpose, and the recipient shall not encumber the property without approval of the Federal awarding agency. When no longer needed for the originally authorized purpose, disposition of the intangible property shall occur in accordance with the provisions of paragraph .34(g).

§___.37 Property trust relationship.

Real property, equipment, intangible property and debt instruments that are acquired or improved with Federal funds shall be held in trust by the recipient as trustee for the beneficiaries of the project or program under which the property was acquired or improved. Agencies may require recipients to record liens or other appropriate notices of record to indicate that personal or real property has been acquired or improved with Federal funds and that use and disposition conditions apply to the property.

Procurement Standards

§___.40 Purpose of procurement standards.

§§___.41 through ___.48 set forth standards for use by recipients in establishing procedures for the procurement of supplies and other expendable property, equipment, real property and other services with Federal funds. These standards are furnished to ensure that such materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal statutes and executive orders. No additional procurement standards or requirements shall be imposed by the Federal awarding agencies upon recipients, unless specifically required by Federal statute or executive order or approved by OMB.

§___.41 Recipient responsibilities.

The standards contained in this section do not relieve the recipient of the contractual responsibilities arising under its contract(s). The recipient is the responsible authority, without recourse to the Federal awarding agency, regarding the settlement and satisfaction of all contractual and administrative issues arising out of procurements entered into in support of an award or other agreement. This includes disputes, claims, protests of award, source evaluation or other matters of a contractual nature. Matters concerning violation of statute are to be referred to such Federal, State or local authority as may have proper jurisdiction.

§___.42 Codes of conduct.

The recipient shall maintain written standards of conduct governing the performance of its employees engaged in the award and administration of contracts. No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award. The officers, employees, and agents of the recipient shall neither solicit nor accept gratuities, favors, or anything of monetary value from contractors, or parties to subagreements. However, recipients may set standards for situations in which the financial interest is not substantial or the gift is an unsolicited item of nominal value. The standards of conduct shall provide for disciplinary actions to be applied for violations of such standards by officers, employees, or agents of the recipient.

§___.43 Competition.

All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurements. Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. Solicitations shall clearly set forth all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so.

§___.44 Procurement procedures.

(a) All recipients shall establish written procurement procedures. These procedures shall provide for, at a minimum, that (1), (2) and (3) apply.

(1) Recipients avoid purchasing unnecessary items.

(2) Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the Federal Government.

(3) Solicitations for goods and services provide for all of the following.

(i) A clear and accurate description of the technical requirements for the material, product or service to be procured. In competitive procurements, such a description shall not contain features which unduly restrict competition.

(ii) Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids or proposals.

(iii) A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards.

(iv) The specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation.

(v) The acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement.

(vi) Preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient.

(b) Positive efforts shall be made by recipients to utilize small businesses, minority-owned firms, and women's business enterprises, whenever possible. Recipients of Federal awards shall take all of the following steps to further this goal.

(1) Ensure that small businesses, minority-owned firms, and women's business enterprises are used to the fullest extent practicable.

(2) Make information on forthcoming opportunities available and arrange time frames for purchases and contracts to encourage and facilitate participation by small businesses, minority-owned firms, and women's business enterprises.

(3) Consider in the contract process whether firms competing for larger contracts intend to subcontract with small businesses, minority-owned firms, and women's business enterprises.

(4) Encourage contracting with consortiums of small businesses, minority-owned firms and women's business enterprises when a contract is too large for one of these firms to handle individually.

(5) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration and the Department of Commerce's Minority Business Development Agency in the solicitation and utilization of small businesses, minority-owned firms and women's business enterprises.

(c) The type of procuring instruments used (e.g., fixed price contracts, cost reimbursable contracts, purchase orders, and incentive contracts) shall be determined by the recipient but shall be appropriate for the particular procurement and for promoting the best interest of the program or project involved. The "cost-plus-a-percentage-of-cost" or "percentage of construction cost" methods of contracting shall not be used.

(d) Contracts shall be made only with responsible contractors who possess the potential ability to perform successfully under the terms and conditions of the proposed procurement. Consideration shall be given to such matters as contractor integrity, record of past performance, financial and technical resources or accessibility to other necessary resources. In certain circumstances, contracts with certain parties are restricted by agencies' implementation of E.O.s 12549 and 12689, "Debarment and Suspension."

(e) Recipients shall, on request, make available for the Federal awarding agency, pre-award review and procurement documents, such as request for proposals or invitations for bids, independent cost estimates, etc., when any of the following conditions apply.

(1) A recipient's procurement procedures or operation fails to comply with the procurement standards in the Federal awarding agency's implementation of this Circular.

(2) The procurement is expected to exceed the small purchase threshold fixed at 41 U.S.C. 403 (11) (currently $25,000) and is to be awarded without competition or only one bid or offer is received in response to a solicitation.

(3) The procurement, which is expected to exceed the small purchase threshold, specifies a "brand name" product.

(4) The proposed award over the small purchase threshold is to be awarded to other than the apparent low bidder under a sealed bid procurement.

(5) A proposed contract modification changes the scope of a contract or increases the contract amount by more than the amount of the small purchase threshold.

§___.45 Cost and price analysis.

Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability and allowability.

§___.46 Procurement records.

Procurement records and files for purchases in excess of the small purchase threshold shall include the following at a minimum: (a) basis for contractor selection, (b) justification for lack of competition when competitive bids or offers are not obtained, and (c) basis for award cost or price.

§___.47 Contract administration.

A system for contract administration shall be maintained to ensure contractor conformance with the terms, conditions and specifications of the contract and to ensure adequate and timely follow up of all purchases. Recipients shall evaluate contractor performance and document, as appropriate, whether contractors have met the terms, conditions and specifications of the contract.

§___.48 Contract provisions.

The recipient shall include, in addition to provisions to define a sound and complete agreement, the following provisions in all contracts. The following provisions shall also be applied to subcontracts.

(a) Contracts in excess of the small purchase threshold shall contain contractual provisions or conditions that allow for administrative, contractual, or legal remedies in instances in which a contractor violates or breaches the contract terms, and provide for such remedial actions as may be appropriate.

(b) All contracts in excess of the small purchase threshold shall contain suitable provisions for termination by the recipient, including the manner by which termination shall be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

(c) Except as otherwise required by statute, an award that requires the contracting (or subcontracting) for construction or facility improvements shall provide for the recipient to follow its own requirements relating to bid guarantees, performance bonds, and payment bonds unless the construction contract or subcontract exceeds $100,000. For those contracts or subcontracts exceeding $100,000, the Federal awarding agency may accept the bonding policy and requirements of the recipient, provided the Federal awarding agency has made a determination that the Federal Government's interest is adequately protected. If such a determination has not been made, the minimum requirements shall be as follows.

(1) A bid guarantee from each bidder equivalent to five percent of the bid price. The "bid guarantee" shall consist of a firm commitment such as a bid bond, certified check, or other negotiable instrument accompanying a bid as assurance that the bidder shall, upon acceptance of his bid, execute such contractual documents as may be required within the time specified.

(2) A performance bond on the part of the contractor for 100 percent of the contract price. A "performance bond" is one executed in connection with a contract to secure fulfillment of all the contractor's obligations under such contract.

(3) A payment bond on the part of the contractor for 100 percent of the contract price. A "payment bond" is one executed in connection with a contract to assure payment as required by statute of all persons supplying labor and material in the execution of the work provided for in the contract.

(4) Where bonds are required in the situations described herein, the bonds shall be obtained from companies holding certificates of authority as acceptable sureties pursuant to 31 CFR part 223, "Surety Companies Doing Business with the United States."

(d) All negotiated contracts (except those for less than the small purchase threshold) awarded by recipients shall include a provision to the effect that the recipient, the Federal awarding agency, the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any books, documents, papers and records of the contractor which are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts and transcriptions.

(e) All contracts, including small purchases, awarded by recipients and their contractors shall contain the procurement provisions of Appendix A to this Circular, as applicable.

Reports and Records

§___.50 Purpose of reports and records.

§§___.51 through ___.53 set forth the procedures for monitoring and reporting on the recipient's financial and program performance and the necessary standard reporting forms. They also set forth record retention requirements.

§___.51 Monitoring and reporting program performance.

(a) Recipients are responsible for managing and monitoring each project, program, subaward, function or activity supported by the award. Recipients shall monitor subawards to ensure subrecipients have met the audit requirements as delineated in §___.26.

(b) The Federal awarding agency shall prescribe the frequency with which the performance reports shall be submitted. Except as provided in paragraph ___.51(f), performance reports shall not be required more frequently than quarterly or, less frequently than annually. Annual reports shall be due 90 calendar days after the grant year; quarterly or semi-annual reports shall be due 30 days after the reporting period. The Federal awarding agency may require annual reports before the anniversary dates of multiple year awards in lieu of these requirements. The final performance reports are due 90 calendar days after the expiration or termination of the award.

(c) If inappropriate, a final technical or performance report shall not be required after completion of the project.

(d) When required, performance reports shall generally contain, for each award, brief information on each of the following.

(1) A comparison of actual accomplishments with the goals and objectives established for the period, the findings of the investigator, or both. Whenever appropriate and the output of programs or projects can be readily quantified, such quantitative data should be related to cost data for computation of unit costs.

(2) Reasons why established goals were not met, if appropriate.

(3) Other pertinent information including, when appropriate, analysis and explanation of cost overruns or high unit costs.

(e) Recipients shall not be required to submit more than the original and two copies of performance reports.

(f) Recipients shall immediately notify the Federal awarding agency of developments that have a significant impact on the award-supported activities. Also, notification shall be given in the case of problems, delays, or adverse conditions which materially impair the ability to meet the objectives of the award. This notification shall include a statement of the action taken or contemplated, and any assistance needed to resolve the situation.

(g) Federal awarding agencies may make site visits, as needed.

(h) Federal awarding agencies shall comply with clearance requirements of 5 CFR part 1320 when requesting performance data from recipients.

§___.52 Financial reporting.

(a) The following forms or such other forms as may be approved by OMB are authorized for obtaining financial information from recipients.

(1) SF-269 or SF-269A, Financial Status Report.

(i) Each Federal awarding agency shall require recipients to use the SF-269 or SF-269A to report the status of funds for all nonconstruction projects or programs. A Federal awarding agency may, however, have the option of not requiring the SF-269 or SF-269A when the SF-270, Request for Advance or Reimbursement, or SF-272, Report of Federal Cash Transactions, is determined to provide adequate information to meet its needs, except that a final SF-269 or SF-269A shall be required at the completion of the project when the SF-270 is used only for advances.

(ii) The Federal awarding agency shall prescribe whether the report shall be on a cash or accrual basis. If the Federal awarding agency requires accrual information and the recipient's accounting records are not normally kept on the accrual basis, the recipient shall not be required to convert its accounting system, but shall develop such accrual information through best estimates based on an analysis of the documentation on hand.

(iii) The Federal awarding agency shall determine the frequency of the Financial Status Report for each project or program, considering the size and complexity of the particular project or program. However, the report shall not be required more frequently than quarterly or less frequently than annually. A final report shall be required at the completion of the agreement.

(iv) The Federal awarding agency shall require recipients to submit the SF-269 or SF-269A (an original and no more than two copies) no later than 30 days after the end of each specified reporting period for quarterly and semi-annual reports, and 90 calendar days for annual and final reports. Extensions of reporting due dates may be approved by the Federal awarding agency upon request of the recipient.

(2) SF-272, Report of Federal Cash Transactions.

(i) When funds are advanced to recipients the Federal awarding agency shall require each recipient to submit the SF-272 and, when necessary, its continuation sheet, SF-272a. The Federal awarding agency shall use this report to monitor cash advanced to recipients and to obtain disbursement information for each agreement with the recipients.

(ii) Federal awarding agencies may require forecasts of Federal cash requirements in the "Remarks" section of the report.

(iii) When practical and deemed necessary, Federal awarding agencies may require recipients to report in the "Remarks" section the amount of cash advances received in excess of three days. Recipients shall provide short narrative explanations of actions taken to reduce the excess balances.

(iv) Recipients shall be required to submit not more than the original and two copies of the SF-272 15 calendar days following the end of each quarter. The Federal awarding

agencies may require a monthly report from those recipients receiving advances totaling $1 million or more per year.

(v) Federal awarding agencies may waive the requirement for submission of the SF-272 for any one of the following reasons: (1) When monthly advances do not exceed $25,000 per recipient, provided that such advances are monitored through other forms contained in this section; (2) If, in the Federal awarding agency's opinion, the recipient's accounting controls are adequate to minimize excessive Federal advances; or, (3) When the electronic payment mechanisms provide adequate data.

(b) When the Federal awarding agency needs additional information or more frequent reports, the following shall be observed.

(1) When additional information is needed to comply with legislative requirements, Federal awarding agencies shall issue instructions to require recipients to submit such information under the "Remarks" section of the reports.

(2) When a Federal awarding agency determines that a recipient's accounting system does not meet the standards in §___.21, additional pertinent information to further monitor awards may be obtained upon written notice to the recipient until such time as the system is brought up to standard. The Federal awarding agency, in obtaining this information, shall comply with report clearance requirements of 5 CFR part 1320.

(3) Federal awarding agencies are encouraged to shade out any line item on any report if not necessary.

(4) Federal awarding agencies may accept the identical information from the recipients in machine readable format or computer printouts or electronic outputs in lieu of prescribed formats.

(5) Federal awarding agencies may provide computer or electronic outputs to recipients when such expedites or contributes to the accuracy of reporting.

§___.53 Retention and access requirements for records.

(a) This section sets forth requirements for record retention and access to records for awards to recipients. Federal awarding agencies shall not impose any other record retention or access requirements upon recipients.

(b) Financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years from the date of submission of the final expenditure report or, for awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report, as authorized by the Federal awarding agency. The only exceptions are the following.

(1) If any litigation, claim, or audit is started before the expiration of the 3-year period, the records shall be retained until all litigation, claims or audit findings involving the records have been resolved and final action taken.

(2) Records for real property and equipment acquired with Federal funds shall be retained for 3 years after final disposition.

(3) When records are transferred to or maintained by the Federal awarding agency, the 3-year retention requirement is not applicable to the recipient.

(4) Indirect cost rate proposals, cost allocations plans, etc. as specified in paragraph ___.53(g).

(c) Copies of original records may be substituted for the original records if authorized by the Federal awarding agency.

(d) The Federal awarding agency shall request transfer of certain records to its custody from recipients when it determines that the records possess long term retention value. However, in order to avoid duplicate recordkeeping, a Federal awarding agency may make arrangements for recipients to retain any records that are continuously needed for joint use.

(e) The Federal awarding agency, the Inspector General, Comptroller General of the United States, or any of their duly authorized representatives, have the right of timely and unrestricted access to any books, documents, papers, or other records of recipients that are pertinent to the awards, in order to make audits, examinations, excerpts, transcripts and copies of such documents. This right also includes timely and reasonable access to a recipient's personnel for the purpose of interview and discussion related to such documents. The rights of access in this paragraph are not limited to the required retention period, but shall last as long as records are retained.

(f) Unless required by statute, no Federal awarding agency shall place restrictions on recipients that limit public access to the records of recipients that are pertinent to an award, except when the Federal awarding agency can demonstrate that such records shall be kept confidential and would have been exempted from disclosure pursuant to the Freedom of Information Act (5 U.S.C. 552) if the records had belonged to the Federal awarding agency.

(g) Indirect cost rate proposals, cost allocations plans, etc. Paragraphs (g) (1) and (g)(2) apply to the following types of documents, and their supporting records: indirect cost rate computations or proposals, cost allocation plans, and any similar accounting computations of the rate at which a particular group of costs is chargeable (such as computer usage chargeback rates or composite fringe benefit rates).

(1) If submitted for negotiation. If the recipient submits to the Federal awarding agency or the subrecipient submits to the recipient the proposal, plan, or other computation to form the basis for negotiation of the rate, then the 3-year retention period for its supporting records starts on the date of such submission.

(2) If not submitted for negotiation. If the recipient is not required to submit to the Federal awarding agency or the subrecipient is not required to submit to the recipient the proposal, plan, or other computation for negotiation purposes, then the 3-year retention period for the proposal, plan, or other computation and its supporting records starts at the end of the fiscal year (or other accounting period) covered by the proposal, plan, or other computation.

Termination and Enforcement

§___.60 Purpose of termination and enforcement.

§§___.61 and ___.62 set forth uniform suspension, termination and enforcement procedures.

§___.61 Termination.

(a) Awards may be terminated in whole or in part only if (1), (2) or (3) apply.

(1) By the Federal awarding agency, if a recipient materially fails to comply with the terms and conditions of an award.

(2) By the Federal awarding agency with the consent of the recipient, in which case the two parties shall agree upon the termination conditions, including the effective date and, in the case of partial termination, the portion to be terminated.

(3) By the recipient upon sending to the Federal awarding agency written notification setting forth the reasons for such termination, the effective date, and, in the case of partial termination, the portion to be terminated. However, if the Federal awarding agency determines in the case of partial termination that the reduced or modified portion of the grant will not accomplish the purposes for which the grant was made, it may terminate the grant in

its entirety under either paragraphs (a)(1) or (2).

(b) If costs are allowed under an award, the responsibilities of the recipient referred to in paragraph ___.71(a), including those for property management as applicable, shall be considered in the termination of the award, and provision shall be made for continuing responsibilities of the recipient after termination, as appropriate.

§___.62 Enforcement.

(a) Remedies for noncompliance. If a recipient materially fails to comply with the terms and conditions of an award, whether stated in a Federal statute, regulation, assurance, application, or notice of award, the Federal awarding agency may, in addition to imposing any of the special conditions outlined in §___.14, take one or more of the following actions, as appropriate in the circumstances.

(1) Temporarily withhold cash payments pending correction of the deficiency by the recipient or more severe enforcement action by the Federal awarding agency.

(2) Disallow (that is, deny both use of funds and any applicable matching credit for) all or part of the cost of the activity or action not in compliance.

(3) Wholly or partly suspend or terminate the current award.

(4) Withhold further awards for the project or program.

(5) Take other remedies that may be legally available.

(b) Hearings and appeals. In taking an enforcement action, the awarding agency shall provide the recipient an opportunity for hearing, appeal, or other administrative proceeding to which the recipient is entitled under any statute or regulation applicable to the action involved.

(c) Effects of suspension and termination. Costs of a recipient resulting from obligations incurred by the recipient during a suspension or after termination of an award are not allowable unless the awarding agency expressly authorizes them in the notice of suspension or termination or subsequently. Other recipient costs during suspension or after termination which are necessary and not reasonably avoidable are allowable if (1) and (2) apply.

(1) The costs result from obligations which were properly incurred by the recipient before the effective date of suspension or termination, are not in anticipation of it, and in the case of a termination, are noncancellable.

(2) The costs would be allowable if the award were not suspended or expired normally at the end of the funding period in which the termination takes effect.

(d) Relationship to debarment and suspension. The enforcement remedies identified in this section, including suspension and termination, do not preclude a recipient from being subject to debarment and suspension under E.O.s 12549 and 12689 and the Federal awarding agency implementing regulations (see §___.13).

Subpart D — After-the-Award Requirements

§___.70 Purpose.

§§___.71 through ___.73 contain closeout procedures and other procedures for subsequent disallowances and adjustments.

§___.71 Closeout procedures.

(a) Recipients shall submit, within 90 calendar days after the date of completion of the award, all financial, performance, and other reports as required by the terms and conditions of the award. The Federal awarding agency may approve extensions when requested by the recipient.

(b) Unless the Federal awarding agency authorizes an extension, a recipient shall liquidate all obligations incurred under the award not later than 90 calendar days after the funding period or the date of completion as specified in the terms and conditions of the award or in agency implementing instructions.

(c) The Federal awarding agency shall make prompt payments to a recipient for allowable reimbursable costs under the award being closed out.

(d) The recipient shall promptly refund any balances of unobligated cash that the Federal awarding agency has advanced or paid and that is not authorized to be retained by the recipient for use in other projects. OMB Circular A-129 governs unreturned amounts that become delinquent debts.

(e) When authorized by the terms and conditions of the award, the Federal awarding agency shall make a settlement for any upward or downward adjustments to the Federal share of costs after closeout reports are received.

(f) The recipient shall account for any real and personal property acquired with Federal funds or received from the Federal Government in accordance with §§___.31 through ___.37.

(g) In the event a final audit has not been performed prior to the closeout of an award, the Federal awarding agency shall retain the right to recover an appropriate amount after fully considering the recommendations on disallowed costs resulting from the final audit.

§___.72 Subsequent adjustments and continuing responsibilities.

(a) The closeout of an award does not affect any of the following.

(1) The right of the Federal awarding agency to disallow costs and recover funds on the basis of a later audit or other review.

(2) The obligation of the recipient to return any funds due as a result of later refunds, corrections, or other transactions.

(3) Audit requirements in §___.26.

(4) Property management requirements in §§___.31 through ___.37.

(5) Records retention as required in §___.53.

(b) After closeout of an award, a relationship created under an award may be modified or ended in whole or in part with the consent of the Federal awarding agency and the recipient, provided the responsibilities of the recipient referred to in paragraph ___.73(a), including those for property management as applicable, are considered and provisions made for continuing responsibilities of the recipient, as appropriate.

§___.73 Collection of amounts due.

(a) Any funds paid to a recipient in excess of the amount to which the recipient is finally determined to be entitled under the terms and conditions of the award constitute a debt to the Federal Government. If not paid within a reasonable period after the demand for payment, the Federal awarding agency may reduce the debt by (1), (2) or (3).

(1) Making an administrative offset against other requests for reimbursements.

(2) Withholding advance payments otherwise due to the recipient.

(3) Taking other action permitted by statute.

(b) Except as otherwise provided by law, the Federal awarding agency shall charge interest on an overdue debt in accordance with 4 CFR Chapter II, "Federal Claims Collection Standards."

Appendix A — Contract Provisions

All contracts, awarded by a recipient including small purchases, shall contain the following provisions as applicable:

1. *Equal Employment Opportunity*—All contracts shall contain a provision requiring compliance with E.O. 11246, "Equal Employment Opportunity," as amended by E.O.

11375, "Amending Executive Order 11246 Relating to Equal Employment Opportunity," and as supplemented by regulations at 41 CFR part 60, "Office of Federal Contract Compliance Programs, Equal Employment Opportunity, Department of Labor."

2. *Copeland "Anti-Kickback" Act (18 U.S.C. 874 and 40 U.S.C. 276c)*—All contracts and subgrants in excess of $2,000 for construction or repair awarded by recipients and subrecipients shall include a provision for compliance with the Copeland "Anti-Kickback" Act (18 U.S.C. 874), as supplemented by Department of Labor regulations (29 CFR part 3, "Contractors and Subcontractors on Public Building or Public Work Financed in Whole or in Part by Loans or Grants from the United States"). The Act provides that each contractor or subrecipient shall be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he is otherwise entitled. The recipient shall report all suspected or reported violations to the Federal awarding agency.

3. *Davis-Bacon Act, as amended (40 U.S.C. 276a to a-7)*—When required by Federal program legislation, all construction contracts awarded by the recipients and subrecipients of more than $2,000 shall include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 276a to a-7) and as supplemented by Department of Labor regulations (29 CFR part 5, "Labor Standards Provisions Applicable to Contracts Governing Federally Financed and Assisted Construction"). Under this Act, contractors shall be required to pay wages to laborers and mechanics at a rate not less than the minimum wages specified in a wage determination made by the Secretary of Labor. In addition, contractors shall be required to pay wages not less than once a week. The recipient shall place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation and the award of a contract shall be conditioned upon the acceptance of the wage determination. The recipient shall report all suspected or reported violations to the Federal awarding agency.

4. *Contract Work Hours and Safety Standards Act (40 U.S.C. 327-333)*—Where applicable, all contracts awarded by recipients in excess of $2,000 for construction contracts and in excess of $2,500 for other contracts that involve the employment of mechanics or laborers shall include a provision for compliance with Sections 102 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327-333), as supplemented by Department of Labor regulations (29 CFR part 5). Under Section 102 of the Act, each contractor shall be required to compute the wages of every mechanic and laborer on the basis of a standard work week of 40 hours. Work in excess of the standard work week is permissible provided that the worker is compensated at a rate of not less than 1 1/2 times the basic rate of pay for all hours worked in excess of 40 hours in the work week. Section 107 of the Act is applicable to construction work and provides that no laborer or mechanic shall be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

5. *Rights to Inventions Made Under a Contract or Agreement*—Contracts or agreements for the performance of experimental, developmental, or research work shall provide for the rights of the Federal Government and the recipient in any resulting invention in accordance with 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements," and any implementing regulations issued by the awarding agency.

6. *Clean Air Act (42 U.S.C. 7401 et seq.) and the Federal Water Pollution Control Act (33 U.S.C. 1251 et seq.), as amended*—Contracts and subgrants of amounts in excess of $100,000 shall contain a provision that requires the recipient to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act (42 U.S.C. 7401 et seq.) and the Federal Water Pollution Control Act as amended (33 U.S.C. 1251 et seq.). Violations shall be reported to the Federal awarding agency and the Regional Office of the Environmental Protection Agency (EPA).

7. *Byrd Anti-Lobbying Amendment (31 U.S.C. 1352)*—Contractors who apply or bid for an award of $100,000 or more shall file the required certification. Each tier certifies to the tier above that it will not and has not used Federal appropriated funds to pay any person or organization for influencing or attempting to influence an officer or employee of any agency, a member of Congress, officer or employee of Congress, or an employee of a member of Congress in connection with obtaining any Federal contract, grant or any other award covered by 31 U.S.C. 1352. Each tier shall also disclose any lobbying with non-Federal funds that takes place in connection with obtaining any Federal award. Such disclosures are forwarded from tier to tier up to the recipient.

8. *Debarment and Suspension (E.O.s 12549 and 12689)*—No contract shall be made to parties listed on the General Services Administration's List of Parties Excluded from Federal Procurement or Nonprocurement Programs in accordance with E.O.s 12549 and 12689, "Debarment and Suspension." This list contains the names of parties debarred, suspended, or otherwise excluded by agencies, and contractors declared ineligible under statutory or regulatory authority other than E.O. 12549. Contractors with awards that exceed the small purchase threshold shall provide the required certification regarding its exclusion status and that of its principal employees.

The next page is: page 231, ¶1120.

¶1101 Office of Management and Budget Circular A-133 (6/30/97)

OFFICE OF MANAGEMENT AND BUDGET (OMB)

Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations"

June 30, 1997

To the Heads of Executive Departments and Establishments

Subject: Audits of States, Local Governments, and Non-Profit Organizations.

1. *Purpose.* This Circular is issued pursuant to the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156. It sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of States, local governments, and non-profit organizations expending Federal awards.

2. *Authority.* Circular A-133 is issued under the authority of sections 503, 1111, and 7501 et seq. of title 31, United States Code, and Executive Orders 8248 and 11541.

3. *Rescission and Supersession.* This Circular rescinds Circular A-128, "Audits of State and Local Governments," issued April 12, 1985, and supersedes the prior Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions," issued April 22, 1996. For effective dates, see paragraph 10.

4. *Policy.* Except as provided herein, the standards set forth in this Circular shall be applied by all Federal agencies. If any statute specifically prescribes policies or specific requirements that differ from the standards provided herein, the provisions of the subsequent statute shall govern.

Federal agencies shall apply the provisions of the sections of this Circular to non-Federal entities, whether they are recipients expending Federal awards received directly from Federal awarding agencies, or are subrecipients expending Federal awards received from a pass-through entity (a recipient or another subrecipient).

This Circular does not apply to non-U.S. based entities expending Federal awards received either directly as a recipient or indirectly as a subrecipient.

5. *Definitions.* The definitions of key terms used in this Circular are contained in §____.105 in the Attachment to this Circular.

6. *Required Action.* The specific requirements and responsibilities of Federal agencies and non-Federal entities are set forth in the Attachment to this Circular. Federal agencies making awards to non-Federal entities, either directly or indirectly, shall adopt the language in the Circular in codified regulations as provided in Section 10 (below), unless different provisions are required by Federal statute or are approved by the Office of Management and Budget (OMB).

7. *OMB Responsibilities.* OMB will review Federal agency regulations and implementation of this Circular, and will provide interpretations of policy requirements and assistance to ensure uniform, effective and efficient implementation.

8. *Information Contact.* Further information concerning Circular A-133 may be obtained by contacting the Financial Standards and Reporting Branch, Office of Federal Financial Management, Office of Management and Budget, Washington, DC 20503, telephone (202) 395-3993.

9. *Review Date.* This Circular will have a policy review three years from the date of issuance.

10. *Effective Dates.* The standards set forth in §____.400 of the Attachment to this Circular, which apply directly to Federal agencies, shall be effective July 1, 1996, and shall apply to audits of fiscal years beginning after June 30, 1996, except as otherwise specified in §____.400(a).

The standards set forth in this Circular that Federal agencies shall apply to non-Federal entities shall be adopted by Federal agencies in codified regulations not later than 60 days after publication of this final revision in the Federal Register, so that they will apply to audits of fiscal years beginning after June 30, 1996, with the exception that §____.305(b) of the Attachment applies to audits of fiscal years beginning after June 30, 1998. The requirements of Circular A-128, although the Circular is rescinded, and the 1990 version of Circular A-133 remain in effect for audits of fiscal years beginning on or before June 30, 1996.

Franklin D. Raines, Director.

Attachment

PART____ — AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS

Subpart A — General

Sec.

____.100 Purpose.
____.105 Definitions.

Subpart B — Audits

____.200 Audit requirements.
____.205 Basis for determining Federal awards expended.
____.210 Subrecipient and vendor determinations.
____.215 Relation to other audit requirements.
____.220 Frequency of audits.
____.225 Sanctions.
____.230 Audit costs.
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Subpart C — Auditees

____.300 Auditee responsibilities.
____.305 Auditor selection.
____.310 Financial statements.
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____.400 Responsibilities.
____.405 Management decision.

Subpart E — Auditors

____.500 Scope of audit.
____.505 Audit reporting.
____.510 Audit findings.
____.515 Audit working papers.
____.520 Major program determination.
____.525 Criteria for Federal program risk.
____.530 Criteria for a low-risk auditee.

Appendix A to Part____ — Data Collection Form (Form SF-SAC)

Appendix B to Part____ — Circular A-133 Compliance Supplement

Subpart A — General

§____.100 Purpose.

This part sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards.

§____.105 Definitions.

Auditee means any non-Federal entity that expends Federal awards which must be audited under this part.

Auditor means an auditor, that is a public accountant or a Federal, State or local government audit organization, which meets the general standards specified in generally accepted government auditing standards (GAGAS). The term auditor does not include internal auditors of non-profit organizations.

Audit finding means deficiencies which the auditor is required by §____.510(a) to report in the schedule of findings and questioned costs.

CFDA number means the number assigned to a Federal program in the *Catalog of Federal Domestic Assistance (CFDA)*.

Cluster of programs means a grouping of closely related programs that share common compliance requirements. The types of clusters of programs are research and development (R&D), student financial aid (SFA), and other clusters. "Other clusters" are as defined by the Office of Management and Budget (OMB) in the compliance supplement or as designated by a State for Federal awards the State provides to its subrecipients that meet the definition of a cluster of programs. When designating an "other cluster," a State shall identify the Federal awards included in the cluster and advise the subrecipients of compliance requirements applicable to the cluster, consistent with §____.400(d)(1) and §____.400(d)(2), respectively. A cluster of programs shall be considered as one program for determining major programs, as described in §____.520, and, with the exception of R&D as described in §____.200(c), whether a program-specific audit may be elected.

Cognizant agency for audit means the Federal agency designated to carry out the responsibilities described in §____.400(a).

Compliance supplement refers to the *Circular A-133 Compliance Supplement*, included as Appendix B to Circular A-133, or such documents as OMB or its designee may issue to replace it.

This document is available from the Government Printing Office, Superintendent of Documents, Washington, DC 20402-9325.

Corrective action means action taken by the auditee that:

(1) Corrects identified deficiencies;

(2) Produces recommended improvements; or

(3) Demonstrates that audit findings are either invalid or do not warrant auditee action.

Federal agency has the same meaning as the term agency in Section 551(1) of title 5, United States Code.

Federal award means Federal financial assistance and Federal cost-reimbursement contracts that non-Federal entities receive directly from Federal awarding agencies or indirectly from pass-through entities. It does not include procurement contracts, under grants or contracts, used to buy goods or services from vendors. Any audits of such vendors shall be covered by the terms and conditions of the contract. Contracts to operate Federal Government owned, contractor operated facilities (GOCOs) are excluded from the requirements of this part.

Federal awarding agency means the Federal agency that provides an award directly to the recipient.

Federal financial assistance means assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance, but does not include amounts received as reimbursement for services rendered to individuals as described in §____.205(h) and §____.205(i).

Federal program means:

(1) All Federal awards to a non-Federal entity assigned a single number in the CFDA.

(2) When no CFDA number is assigned, all Federal awards from the same agency made for the same purpose should be combined and considered one program.

(3) Notwithstanding paragraphs (1) and (2) of this definition, a cluster of programs. The types of clusters of programs are:

(i) Research and development (R&D);

(ii) Student financial aid (SFA); and

(iii) "Other clusters," as described in the definition of cluster of programs in this section.

GAGAS means generally accepted government auditing standards issued by the Comptroller General of the United States, which are applicable to financial audits.

Generally accepted accounting principles has the meaning specified in generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA).

Indian tribe means any Indian tribe, band, nation, or other organized group or community, including any Alaskan Native village or regional or village corporation (as defined in, or established under, the Alaskan Native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.

Internal control means a process, effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

(1) Effectiveness and efficiency of operations;

(2) Reliability of financial reporting; and

(3) Compliance with applicable laws and regulations.

Internal control pertaining to the compliance requirements for Federal programs (Internal control over Federal programs) means a process — effected by an entity's management and other personnel — designed to provide reasonable assurance regarding the achievement of the following objectives for Federal programs:

(1) Transactions are properly recorded and accounted for to:

(i) Permit the preparation of reliable financial statements and Federal reports;

(ii) Maintain accountability over assets; and

(iii) Demonstrate compliance with laws, regulations, and other compliance requirements;

(2) Transactions are executed in compliance with:

(i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and

(ii) Any other laws and regulations that are identified in the compliance supplement; and

(3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

Loan means a Federal loan or loan guarantee received or administered by a non-Federal entity.

Local government means any unit of local government within a State, including a county, borough, municipality, city, town, township, parish, local public authority, special district, school district, intrastate district, council of governments, and any other instrumentality of local government.

Major program means a Federal program determined by the auditor to be a major program in accordance with §____.520 or a program identified as a major program by a Federal agency or pass-through entity in accordance with §____.215(c).

Management decision means the evaluation by the Federal awarding agency or pass-through entity of the audit findings and corrective action plan and the issuance of a written decision as to what corrective action is necessary.

Non-Federal entity means a State, local government, or non-profit organization.

Non-profit organization means:

(1) any corporation, trust, association, cooperative, or other organization that:

(i) Is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;

(ii) Is not organized primarily for profit; and

(iii) Uses its net proceeds to maintain, improve, or expand its operations; and

(2) The term non-profit organization includes non-profit institutions of higher education and hospitals.

OMB means the Executive Office of the President, Office of Management and Budget.

Oversight agency for audit means the Federal awarding agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency for audit. When there is no direct funding, the Federal agency with the predominant indirect funding shall assume the oversight responsibilities. The duties of the oversight agency for audit are described in §____.400(b).

Pass-through entity means a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program.

Program-specific audit means an audit of one Federal program as provided for in §____.200(c) and §____.235.

Questioned cost means a cost that is questioned by the auditor because of an audit finding:

(1) Which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds;

(2) Where the costs, at the time of the audit, are not supported by adequate documentation; or

(3) Where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

Recipient means a non-Federal entity that expends Federal awards received directly from a Federal awarding agency to carry out a Federal program.

Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-Federal entity. Research is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. The term research also includes activities involving the training of individuals in research techniques where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function. Development is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

Single audit means an audit which includes both the entity's financial statements and the Federal awards as described in §____.500.

State means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, any instrumentality thereof, any multi-State, regional, or interstate entity which has governmental functions, and any Indian tribe as defined in this section.

Student Financial Aid (SFA) includes those programs of general student assistance, such as those authorized by Title IV of the Higher Education Act of 1965, as amended, (20 U.S.C. 1070 et seq.) which is administered by the U.S. Department of Education, and similar programs provided by other Federal agencies. It does not include programs which provide fellowships or similar Federal awards to students on a competitive basis, or for specified studies or research.

Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a recipient of other Federal awards directly from a Federal awarding agency. Guidance on distinguishing between a subrecipient and a vendor is provided in §____.210.

Types of compliance requirements refers to the types of compliance requirements listed in the compliance supplement. Examples include: activities allowed or unallowed; allowable costs/cost principles; cash management; eligibility; matching, level of effort, earmarking; and, reporting.

Vendor means a dealer, distributor, merchant, or other seller providing goods or services that are required for the conduct of a Federal program. These goods or services may be for an organization's own use or for the use of beneficiaries of the Federal program. Additional guidance on distinguishing between a subrecipient and a vendor is provided in §____.210.

Subpart B — Audits

§____.200 Audit requirements.

(a) *Audit required.* Non-Federal entities that expend $300,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part. Guidance on determining Federal awards expended is provided in §____.205.

(b) *Single audit.* Non-Federal entities that expend $300,000 or more in a year in Federal awards shall have a single audit conducted in accordance with §____.500 except when they elect to have a program-specific audit conducted in accordance with paragraph (c) of this section.

(c) *Program-specific audit election.* When an auditee expends Federal awards under only one Federal program (excluding R&D) and the Federal program's laws, regulations, or grant agreements do not require a financial statement audit of the auditee, the auditee may elect to have a program-specific audit conducted in accordance with §____.235. A program-specific audit may not be elected for R&D unless all of the Federal awards expended were received from the same Federal agency, or the same Federal agency and the same pass-through entity, and that Federal agency, or pass-through entity in the case of a subrecipient, approves in advance a program-specific audit.

(d) *Exemption when Federal awards expended are less than $300,000.* Non-Federal entities that expend less than $300,000 a year in Federal awards are exempt from Federal audit requirements for that year, except as noted in §____.215(a), but records must be available for review or audit by appropriate officials of the Federal agency, pass-through entity, and General Accounting Office (GAO).

(e) *Federally Funded Research and Development Centers (FFRDC).* Management of an auditee that owns or operates a FFRDC may elect to treat the FFRDC as a separate entity for purposes of this part.

§____.205 Basis for determining Federal awards expended.

(a) *Determining Federal awards expended.* The determination of when an award is expended should be based on when the activity related to the award occurs. Generally, the activity pertains to events that require the non-Federal entity to comply with laws, regulations, and the provisions of contracts or grant agreements, such as: expenditure/expense transactions associated with grants, cost-reimbursement contracts, cooperative agreements, and direct appropriations; the disbursement of funds passed through to subrecipients; the use of loan proceeds under loan and loan guarantee programs; the receipt of property; the receipt of surplus property; the receipt or use

of program income; the distribution or consumption of food commodities; the disbursement of amounts entitling the non-Federal entity to an interest subsidy; and, the period when insurance is in force.

(b) *Loan and loan guarantees (loans).* Since the Federal Government is at risk for loans until the debt is repaid, the following guidelines shall be used to calculate the value of Federal awards expended under loan programs, except as noted in paragraphs (c) and (d) of this section:

(1) Value of new loans made or received during the fiscal year; plus

(2) Balance of loans from previous years for which the Federal Government imposes continuing compliance requirements; plus

(3) Any interest subsidy, cash, or administrative cost allowance received.

(c) *Loan and loan guarantees (loans) at institutions of higher education.* When loans are made to students of an institution of higher education but the institution does not make the loans, then only the value of loans made during the year shall be considered Federal awards expended in that year. The balance of loans for previous years is not included as Federal awards expended because the lender accounts for the prior balances.

(d) *Prior loan and loan guarantees (loans).* Loans, the proceeds of which were received and expended in prior-years, are not considered Federal awards expended under this part when the laws, regulations, and the provisions of contracts or grant agreements pertaining to such loans impose no continuing compliance requirements other than to repay the loans.

(e) *Endowment funds.* The cumulative balance of Federal awards for endowment funds which are federally restricted are considered awards expended in each year in which the funds are still restricted.

(f) *Free rent.* Free rent received by itself is not considered a Federal award expended under this part. However, free rent received as part of an award to carry out a Federal program shall be included in determining Federal awards expended and subject to audit under this part.

(g) *Valuing non-cash assistance.* Federal non-cash assistance, such as free rent, food stamps, food commodities, donated property, or donated surplus property, shall be valued at fair market value at the time of receipt or the assessed value provided by the Federal agency.

(h) *Medicare.* Medicare payments to a non-Federal entity for providing patient care services to Medicare eligible individuals are not considered Federal awards expended under this part.

(i) *Medicaid.* Medicaid payments to a subrecipient for providing patient care services to Medicaid eligible individuals are not considered Federal awards expended under this part unless a State requires the funds to be treated as Federal awards expended because reimbursement is on a cost-reimbursement basis.

(j) *Certain loans provided by the National Credit Union Administration.* For purposes of this part, loans made from the National Credit Union Share Insurance Fund and the Central Liquidity Facility that are funded by contributions from insured institutions are not considered Federal awards expended.

§____.210 Subrecipient and vendor determinations.

(a) *General.* An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient would be subject to audit under this part. The payments received for goods or services provided as a vendor would not be considered Federal awards. The guidance in paragraphs (b) and (c) of this section should be considered in determining whether payments constitute a Federal award or a payment for goods and services.

(b) *Federal award.* Characteristics indicative of a Federal award received by a subrecipient are when the organization:

(1) Determines who is eligible to receive what Federal financial assistance;

(2) Has its performance measured against whether the objectives of the Federal program are met;

(3) Has responsibility for programmatic decision making;

(4) Has responsibility for adherence to applicable Federal program compliance requirements; and

(5) Uses the Federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

(c) *Payment for goods and services.* Characteristics indicative of a payment for goods and services received by a vendor are when the organization:

(1) Provides the goods and services within normal business operations;

(2) Provides similar goods or services to many different purchasers;

(3) Operates in a competitive environment;

(4) Provides goods or services that are ancillary to the operation of the Federal program; and

(5) Is not subject to compliance requirements of the Federal program.

(d) *Use of judgment in making determination.* There may be unusual circumstances or exceptions to the listed characteristics. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all of the characteristics will be present and judgment should be used in determining whether an entity is a subrecipient or vendor.

(e) *For-profit subrecipient.* Since this part does not apply to for-profit subrecipients, the pass-through entity is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients. The contract with the for-profit subrecipient should describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the contract, and post-award audits.

(f) *Compliance responsibility for vendors.* In most cases, the auditee's compliance responsibility for vendors is only to ensure that the procurement, receipt, and payment for goods and services comply with laws, regulations, and the provisions of contracts or grant agreements. Program compliance requirements normally do not pass through to vendors. However, the auditee is responsible for ensuring compliance for vendor transactions which are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine program compliance. Also, when these vendor transactions relate to a major program, the scope of the audit shall include determining whether these transactions are in compliance with laws, regulations, and the provisions of contracts or grant agreements.

§____.215 Relation to other audit requirements.

(a) *Audit under this part in lieu of other audits.* An audit made in accordance with this part shall be in lieu of any financial audit required under individual Federal awards. To the extent this audit meets a Federal agency's needs, it shall rely upon and use such audits. The provisions of this part neither limit the authority of Federal

agencies, including their Inspectors General, or GAO to conduct or arrange for additional audits (e.g., financial audits, performance audits, evaluations, inspections, or reviews) nor authorize any auditee to constrain Federal agencies from carrying out additional audits. Any additional audits shall be planned and performed in such a way as to build upon work performed by other auditors.

(b) *Federal agency to pay for additional audits.* A Federal agency that conducts or contracts for additional audits shall, consistent with other applicable laws and regulations, arrange for funding the full cost of such additional audits.

(c) *Request for a program to be audited as a major program.* A Federal agency may request an auditee to have a particular Federal program audited as a major program in lieu of the Federal agency conducting or arranging for the additional audits. To allow for planning, such requests should be made at least 180 days prior to the end of the fiscal year to be audited. The auditee, after consultation with its auditor, should promptly respond to such request by informing the Federal agency whether the program would otherwise be audited as a major program using the risk-based audit approach described in §____.520 and, if not, the estimated incremental cost. The Federal agency shall then promptly confirm to the auditee whether it wants the program audited as a major program. If the program is to be audited as a major program based upon this Federal agency request, and the Federal agency agrees to pay the full incremental costs, then the auditee shall have the program audited as a major program. A pass-through entity may use the provisions of this paragraph for a subrecipient.

§____.220 Frequency of audits.

Except for the provisions for biennial audits provided in paragraphs (a) and (b) of this section, audits required by this part shall be performed annually. Any biennial audit shall cover both years within the biennial period.

(a) A State or local government that is required by constitution or statute, in effect on January 1, 1987, to undergo its audits less frequently than annually, is permitted to undergo its audits pursuant to this part biennially. This requirement must still be in effect for the biennial period under audit.

(b) Any non-profit organization that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, is permitted to undergo its audits pursuant to this part biennially.

§____.225 Sanctions.

No audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part. In cases of continued inability or unwillingness to have an audit conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

(a) Withholding a percentage of Federal awards until the audit is completed satisfactorily;

(b) Withholding or disallowing overhead costs;

(c) Suspending Federal awards until the audit is conducted; or

(d) Terminating the Federal award.

§____.230 Audit costs.

(a) *Allowable costs.* Unless prohibited by law, the cost of audits made in accordance with the provisions of this part are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, as determined in accordance with the provisions of applicable OMB cost principles circulars, the Federal Acquisition Regulation (FAR) (48 CFR parts 30 and 31), or other applicable cost principles or regulations.

(b) *Unallowable costs.* A non-Federal entity shall not charge the following to a Federal award:

(1) The cost of any audit under the Single Audit Act Amendments of 1996 (31 U.S.C. 7501 *et seq.*) not conducted in accordance with this part.

(2) The cost of auditing a non-Federal entity which has Federal awards expended of less than $300,000 per year and is thereby exempted under §____.200(d) from having an audit conducted under this part. However, this does not prohibit a pass-through entity from charging Federal awards for the cost of limited scope audits to monitor its subrecipients in accordance with §____.400(d)(3), provided the subrecipient does not have a single audit. For purposes of this part, limited scope audits only include agreed-upon procedures engagements conducted in accordance with either the AICPA's generally accepted auditing standards or attestation standards, that are paid for and arranged by a pass-through entity and address only one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and, reporting.

§____.235 Program-specific audits.

(a) *Program-specific audit guide available.* In many cases, a program-specific audit guide will be available to provide specific guidance to the auditor with respect to internal control, compliance requirements, suggested audit procedures, and audit reporting requirements. The auditor should contact the Office of Inspector General of the Federal agency to determine whether such a guide is available. When a current program-specific audit guide is available, the auditor shall follow GAGAS and the guide when performing a program-specific audit.

(b) *Program-specific audit guide not available.* (1) When a program-specific audit guide is not available, the auditee and auditor shall have basically the same responsibilities for the Federal program as they would have for an audit of a major program in a single audit.

(2) The auditee shall prepare the financial statement(s) for the Federal program that includes, at a minimum, a schedule of expenditures of Federal awards for the program and notes that describe the significant accounting policies used in preparing the schedule, a summary schedule of prior audit findings consistent with the requirements of §____.315(b), and a corrective action plan consistent with the requirements of §____.315(c).

(3) The auditor shall:

(i) Perform an audit of the financial statement(s) for the Federal program in accordance with GAGAS;

(ii) Obtain an understanding of internal control and perform tests of internal control over the Federal program consistent with the requirements of §____.500(c) for a major program;

(iii) Perform procedures to determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on the Federal program consistent with the requirements of §____.500(d) for a major program; and

(iv) Follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee, and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding in accordance with the requirements of §____.500(e).

(4) The auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the

manner presented in this section. The auditor's report(s) shall state that the audit was conducted in accordance with this part and include the following:

(i) An opinion (or disclaimer of opinion) as to whether the financial statement(s) of the Federal program is presented fairly in all material respects in conformity with the stated accounting policies;

(ii) A report on internal control related to the Federal program, which shall describe the scope of testing of internal control and the results of the tests;

(iii) A report on compliance which includes an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on the Federal program; and

(iv) A schedule of findings and questioned costs for the Federal program that includes a summary of the auditor's results relative to the Federal program in a format consistent with §____.505(d)(1) and findings and questioned costs consistent with the requirements of §____.505(d)(3).

(c) *Report submission for program-specific audits.* (1) The audit shall be completed and the reporting required by paragraph (c)(2) or (c)(3) of this section submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the Federal agency that provided the funding or a different period is specified in a program-specific audit guide. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the required reporting shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period, unless a different period is specified in a program-specific audit guide.) Unless restricted by law or regulation, the auditee shall make report copies available for public inspection.

(2) When a program-specific audit guide is available, the auditee shall submit to the Federal clearinghouse designated by OMB the data collection form prepared in accordance with §____.320(b), as applicable to a program-specific audit, and the reporting required by the program-specific audit guide to be retained as an archival copy. Also, the auditee shall submit to the Federal awarding agency or pass-through entity the reporting required by the program-specific audit guide.

(3) When a program-specific audit guide is not available, the reporting package for a program-specific audit shall consist of the financial statement(s) of the Federal program, a summary schedule of prior audit findings, and a corrective action plan as described in paragraph (b)(2) of this section, and the auditor's report(s) described in paragraph (b)(4) of this section. The data collection form prepared in accordance with §____.320(b), as applicable to a program-specific audit, and one copy of this reporting package shall be submitted to the Federal clearinghouse designated by OMB to be retained as an archival copy. Also, when the schedule of findings and questioned costs disclosed audit findings or the summary schedule of prior audit findings reported the status of any audit findings, the auditee shall submit one copy of the reporting package to the Federal clearinghouse on behalf of the Federal awarding agency, or directly to the pass-through entity in the case of a subrecipient. Instead of submitting the reporting package to the pass-through entity, when a subrecipient is not required to submit a reporting package to the pass-through entity, the subrecipient shall provide written notification to the pass-through entity, consistent with the requirements of §____.320(e)(2). A subrecipient may submit a copy of the reporting package to the pass-through entity to comply with this notification requirement.

(d) Other sections of this part may apply. Program-specific audits are subject to §____.100 through §____.215(b), §____.220 through §____.230, §____.300 through §____.305, §____.315, §____.320(f) through §____.320(j), §____.400 through §____.405, §____.510 through §____.515, and other referenced provisions of this part unless contrary to the provisions of this section, a program-specific audit guide, or program laws and regulations.

Subpart C — Auditees

§____.300 Auditee responsibilities.

The auditee shall:

(a) Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

(c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.

(d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with §____.310.

(e) Ensure that the audits required by this part are properly performed and submitted when due. When extensions to the report submission due date required by §____.320(a) are granted by the cognizant or oversight agency for audit, promptly notify the Federal clearinghouse designated by OMB and each pass-through entity providing Federal awards of the extension.

(f) Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan in accordance with §____.315(b) and §____.315(c), respectively.

§____.305 Auditor selection.

(a) *Auditor procurement.* In procuring audit services, auditees shall follow the procurement standards prescribed by the Grants Management Common Rule (hereinafter referred to as the "A-102 Common Rule") published March 11, 1988 and amended April 19, 1995 [insert appropriate CFR citation], Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations," or the FAR (48 CFR part 42), as applicable (OMB Circulars are available from the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503). Whenever possible, auditees shall make positive efforts to utilize small businesses, minority-owned firms, and women's business enterprises, in procuring audit services as stated in the A-102 Common Rule, OMB Circular A-110, or the FAR (48 CFR part 42), as applicable. In requesting proposals for audit services, the objectives and scope of the audit should be made clear. Factors to be considered in evaluating each proposal for audit services include the responsiveness to the request for proposal, relevant experience, availability of staff with professional qualifications and technical abilities, the results of external quality control reviews, and price.

(b) *Restriction on auditor preparing indirect cost proposals.* An auditor who prepares the indirect cost proposal or cost allocation plan may not also be selected to perform the audit required by this part when the indirect costs recovered by the auditee during the prior year exceeded $1 million. This restriction applies to the base year used in the preparation of the indirect cost proposal or cost allocation plan and any subsequent years in which the resulting indirect cost agreement or cost allocation plan is used to recover costs. To minimize any disruption in existing contracts for audit services, this paragraph applies to audits of fiscal years beginning after June 30, 1998.

(c) *Use of Federal auditors.* Federal auditors may perform all or part of the work required under this part if they comply fully with the requirements of this part.

§____.310 Financial statements.

(a) *Financial statements.* The auditee shall prepare financial statements that reflect its financial position, results of operations or changes in net assets, and, where appropriate, cash flows for the fiscal year audited. The financial statements shall be for the same organizational unit and fiscal year that is chosen to meet the requirements of this part. However, organization-wide financial statements may also include departments, agencies, and other organizational units that have separate audits in accordance with §____.500(a) and prepare separate financial statements.

(b) *Schedule of expenditures of Federal awards.* The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. While not required, the auditee may choose to provide information requested by Federal awarding agencies and pass-through entities to make the schedule easier to use. For example, when a Federal program has multiple award years, the auditee may list the amount of Federal awards expended for each award year separately. At a minimum, the schedule shall:

(1) List individual Federal programs by Federal agency. For Federal programs included in a cluster of programs, list individual Federal programs within a cluster of programs. For R&D, total Federal awards expended shall be shown either by individual award or by Federal agency and major subdivision within the Federal agency. For example, the National Institutes of Health is a major subdivision in the Department of Health and Human Services.

(2) For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity shall be included.

(3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.

(4) Include notes that describe the significant accounting policies used in preparing the schedule.

(5) To the extent practical, pass-through entities should identify in the schedule the total amount provided to subrecipients from each Federal program.

(6) Include, in either the schedule or a note to the schedule, the value of the Federal awards expended in the form of noncash assistance, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year end. While not required, it is preferable to present this information in the schedule.

§____.315 Audit findings follow-up.

(a) *General.* The auditee is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the auditee shall prepare a summary schedule of prior audit findings. The auditee shall also prepare a corrective action plan for current year audit findings. The summary schedule of prior audit findings and the corrective action plan shall include the reference numbers the auditor assigns to audit findings under §____.510(c). Since the summary schedule may include audit findings from multiple years, it shall include the fiscal year in which the finding initially occurred.

(b) *Summary schedule of prior audit findings.* The summary schedule of prior audit findings shall report the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to Federal awards. The summary schedule shall also include audit findings reported in the prior audit's summary schedule of prior audit findings except audit findings listed as corrected in accordance with paragraph (b)(1) of this section, or no longer valid or not warranting further action in accordance with paragraph (b)(4) of this section.

(1) When audit findings were fully corrected, the summary schedule need only list the audit findings and state that corrective action was taken.

(2) When audit findings were not corrected or were only partially corrected, the summary schedule shall describe the planned corrective action as well as any partial corrective action taken.

(3) When corrective action taken is significantly different from corrective action previously reported in a corrective action plan or in the Federal agency's or pass-through entity's management decision, the summary schedule shall provide an explanation.

(4) When the auditee believes the audit findings are no longer valid or do not warrant further action, the reasons for this position shall be described in the summary schedule. A valid reason for considering an audit finding as not warranting further action is that all of the following have occurred:

(i) Two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse;

(ii) The Federal agency or pass-through entity is not currently following up with the auditee on the audit finding; and

(iii) A management decision was not issued.

(c) *Corrective action plan.* At the completion of the audit, the auditee shall prepare a corrective action plan to address each audit finding included in the current year auditor's reports. The corrective action plan shall provide the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. If the auditee does not agree with the audit findings or believes corrective action is not required, then the corrective action plan shall include an explanation and specific reasons.

§____.320 Report submission.

(a) *General.* The audit shall be completed and the data collection form described in paragraph (b) of this section and reporting package described in paragraph (c) of this section shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the data collection form and reporting package shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period.) Unless restricted by law or regulation, the auditee shall make copies available for public inspection.

(b) *Data Collection.* (1) The auditee shall submit a data collection form which states

whether the audit was completed in accordance with this part and provides information about the auditee, its Federal programs, and the results of the audit. The form shall be approved by OMB, available from the Federal clearinghouse designated by OMB, and include data elements similar to those presented in this paragraph. A senior level representative of the auditee (e.g., State controller, director of finance, chief executive officer, or chief financial officer) shall sign a statement to be included as part of the form certifying that: the auditee complied with the requirements of this part, the form was prepared in accordance with this part (and the instructions accompanying the form), and the information included in the form, in its entirety, are accurate and complete.

(2) The data collection form shall include the following data elements:

(i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).

(ii) Where applicable, a statement that reportable conditions in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses.

(iii) A statement as to whether the audit disclosed any noncompliance which is material to the financial statements of the auditee.

(iv) Where applicable, a statement that reportable conditions in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses.

(v) The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).

(vi) A list of the Federal awarding agencies which will receive a copy of the reporting package pursuant to §____.320(d)(2).

(vii) A yes or no statement as to whether the auditee qualified as a low-risk auditee under §____.530.

(viii) The dollar threshold used to distinguish between Type A and Type B programs as defined in §____.520(b).

(ix) *The Catalog of Federal Domestic Assistance* (CFDA) number for each Federal program, as applicable.

(x) The name of each Federal program and identification of each major program. Individual programs within a cluster of programs should be listed in the same level of detail as they are listed in the schedule of expenditures of Federal awards.

(xi) The amount of expenditures in the schedule of expenditures of Federal awards associated with each Federal program.

(xii) For each Federal program, a yes or no statement as to whether there are audit findings in each of the following types of compliance requirements and the total amount of any questioned costs:

(A) Activities allowed or unallowed.

(B) Allowable costs/cost principles.

(C) Cash management.

(D) Davis-Bacon Act.

(E) Eligibility.

(F) Equipment and real property management.

(G) Matching, level of effort, earmarking.

(H) Period of availability of Federal funds.

(I) Procurement and suspension and debarment.

(J) Program income.

(K) Real property acquisition and relocation assistance.

(L) Reporting.

(M) Subrecipient monitoring.

(N) Special tests and provisions.

(xiii) Auditee Name, Employer Identification Number(s), Name and Title of Certifying Official, Telephone Number, Signature, and Date.

(xiv) Auditor Name, Name and Title of Contact Person, Auditor Address, Auditor Telephone Number, Signature, and Date.

(xv) Whether the auditee has either a cognizant or oversight agency for audit.

(xvi) The name of the cognizant or oversight agency for audit determined in accordance with §____.400(a) and §____.400(b), respectively.

(3) Using the information included in the reporting package described in paragraph (c) of this section, the auditor shall complete the applicable sections of the form. The auditor shall sign a statement to be included as part of the data collection form that indicates, at a minimum, the source of the information included in the form, the auditor's responsibility for the information, that the form is not a substitute for the reporting package described in paragraph (c) of this section, and that the content of the form is limited to the data elements prescribed by OMB.

(c) *Reporting package.* The reporting package shall include the:

(1) Financial statements and schedule of expenditures of Federal awards discussed in §____.310(a) and §____.310(b), respectively;

(2) Summary schedule of prior audit findings discussed in §____.315(b);

(3) Auditor's report(s) discussed in §____.505; and

(4) Corrective action plan discussed in §____.315(c).

(d) *Submission to clearinghouse.* All auditees shall submit to the Federal clearinghouse designated by OMB the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section for:

(1) The Federal clearinghouse to retain as an archival copy; and

(2) Each Federal awarding agency when the schedule of findings and questioned costs disclosed audit findings relating to Federal awards that the Federal awarding agency provided directly or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the Federal awarding agency provided directly.

(e) *Additional submission by subrecipients.* (1) In addition to the requirements discussed in paragraph (d) of this section, auditees that are also subrecipients shall submit to each pass-through entity one copy of the reporting package described in paragraph (c) of this section for each pass-through entity when the schedule of findings and questioned costs disclosed audit findings relating to Federal awards that the pass-through entity provided or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the pass-through entity provided.

(2) Instead of submitting the reporting package to a pass-through entity, when a subrecipient is not required to submit a reporting package to a pass-through entity pursuant to paragraph (e)(1) of this section, the subrecipient shall provide written notification to the pass-through entity that: an audit of the subrecipient was conducted in accordance with this part (including the period covered by the audit and the name, amount, and CFDA number of the Federal award(s) provided by the pass-through entity); the schedule of findings and questioned costs disclosed no audit findings relating to the Federal award(s) that the pass-through entity provided; and, the summary schedule of prior audit findings did not report on the status of any audit findings relating to the Federal award(s) that the pass-through entity provided. A subrecipient may submit a copy of the reporting package described in paragraph (c) of this section to a pass-through entity to comply with this notification requirement.

(f) *Requests for report copies.* In response to requests by a Federal agency or pass-through entity, auditees shall submit the appropriate copies of the reporting package described in paragraph (c) of this section and, if requested, a copy of any management letters issued by the auditor.

(g) *Report retention requirements.* Auditees shall keep one copy of the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section on file for three years from the date of submission to the Federal clearinghouse designated by OMB. Pass-through entities shall keep subrecipients' submissions on file for three years from date of receipt.

(h) *Clearinghouse responsibilities.* The Federal clearinghouse designated by OMB shall distribute the reporting packages received in accordance with paragraph (d)(2) of this section and §____.235(c)(3) to applicable Federal awarding agencies, maintain a data base of completed audits, provide appropriate information to Federal agencies, and follow up with known auditees which have not submitted the required data collection forms and reporting packages.

(i) *Clearinghouse address.* The address of the Federal clearinghouse currently designated by OMB is Federal Audit Clearinghouse, Bureau of the Census, 1201 E. 10th Street, Jeffersonville, IN 47132.

(j) *Electronic filing.* Nothing in this part shall preclude electronic submissions to the Federal clearinghouse in such manner as may be approved by OMB. With OMB approval, the Federal clearinghouse may pilot test methods of electronic submissions.

Subpart D — Federal Agencies and Pass-Through Entities

§____.400 Responsibilities.

(a) *Cognizant agency for audit responsibilities.* Recipients expending more than $25 million a year in Federal awards shall have a cognizant agency for audit. The designated cognizant agency for audit shall be the Federal awarding agency that provides the predominant amount of direct funding to a recipient unless OMB makes a specific cognizant agency for audit assignment. To provide for continuity of cognizance, the determination of the predominant amount of direct funding shall be based upon direct Federal awards expended in the recipient's fiscal years ending in 1995, 2000, 2005, and every fifth year thereafter. For example, audit cognizance for periods ending in 1997 through 2000 will be determined based on Federal awards expended in 1995. (However, for States and local governments that expend more than $25 million a year in Federal awards and have previously assigned cognizant agencies for audit, the requirements of this paragraph are not effective until fiscal years beginning after June 30, 2000.) Notwithstanding the manner in which audit cognizance is determined, a Federal awarding agency with cognizance for an auditee may reassign cognizance to another Federal awarding agency which provides substantial direct funding and agrees to be the cognizant agency for audit. Within 30 days after any reassignment, both the old and the new cognizant agency for audit shall notify the auditee, and, if known, the auditor of the reassignment. The cognizant agency for audit shall:

(1) Provide technical audit advice and liaison to auditees and auditors.

(2) Consider auditee requests for extensions to the report submission due date required by §____.320(a). The cognizant agency for audit may grant extensions for good cause.

(3) Obtain or conduct quality control reviews of selected audits made by non-Federal auditors, and provide the results, when appropriate, to other interested organizations.

(4) Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any direct reporting by the auditee or its auditor of irregularities or illegal acts, as required by GAGAS or laws and regulations.

(5) Advise the auditor and, where appropriate, the auditee of any deficiencies found in the audits when the deficiencies require corrective action by the auditor. When advised of deficiencies, the auditee shall work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency for audit shall notify the auditor, the auditee, and applicable Federal awarding agencies and pass-through entities of the facts and make recommendations for follow-up action. Major inadequacies or repetitive substandard performance by auditors shall be referred to appropriate State licensing agencies and professional bodies for disciplinary action.

(6) Coordinate, to the extent practical, audits or reviews made by or for Federal agencies that are in addition to the audits made pursuant to this part, so that the additional audits or reviews build upon audits performed in accordance with this part.

(7) Coordinate a management decision for audit findings that affect the Federal programs of more than one agency.

(8) Coordinate the audit work and reporting responsibilities among auditors to achieve the most cost-effective audit.

(9) For biennial audits permitted under §____.220, consider auditee requests to qualify as a low-risk auditee under §____.530(a).

(b) *Oversight agency for audit responsibilities.* An auditee which does not have a designated cognizant agency for audit will be under the general oversight of the Federal agency determined in accordance with §____.105. The oversight agency for audit:

(1) Shall provide technical advice to auditees and auditors as requested.

(2) May assume all or some of the responsibilities normally performed by a cognizant agency for audit.

(c) *Federal awarding agency responsibilities.* The Federal awarding agency shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each recipient of the CFDA title and number, award name and number, award year, and if the award is for R&D. When some of this information is not available, the Federal agency shall provide information necessary to clearly describe the Federal award.

(2) Advise recipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements.

(3) Ensure that audits are completed and reports are received in a timely manner and in accordance with the requirements of this part.

(4) Provide technical advice and counsel to auditees and auditors as requested.

(5) Issue a management decision on audit findings within six months after receipt of the audit report and ensure that the recipient takes appropriate and timely corrective action.

(6) Assign a person responsible for providing annual updates of the compliance supplement to OMB.

(d) *Pass-through entity responsibilities.* A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

(2) Advise subrecipients of requirements imposed on them by Federal laws,

regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.

(3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

(4) Ensure that subrecipients expending $300,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

(5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

(6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.

(7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.

§____.405 Management decision.

(a) *General.* The management decision shall clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action. If the auditee has not completed corrective action, a timetable for follow-up should be given. Prior to issuing the management decision, the Federal agency or pass-through entity may request additional information or documentation from the auditee, including a request for auditor assurance related to the documentation, as a way of mitigating disallowed costs. The management decision should describe any appeal process available to the auditee.

(b) *Federal agency.* As provided in §____.400(a)(7), the cognizant agency for audit shall be responsible for coordinating a management decision for audit findings that affect the programs of more than one Federal agency. As provided in §____.400(c)(5), a Federal awarding agency is responsible for issuing a management decision for findings that relate to Federal awards it makes to recipients. Alternate arrangements may be made on a case-by-case basis by agreement among the Federal agencies concerned.

(c) *Pass-through entity.* As provided in §____.400(d)(5), the pass-through entity shall be responsible for making the management decision for audit findings that relate to Federal awards it makes to subrecipients.

(d) *Time requirements.* The entity responsible for making the management decision shall do so within six months of receipt of the audit report. Corrective action should be initiated within six months after receipt of the audit report and proceed as rapidly as possible.

(e) *Reference numbers.* Management decisions shall include the reference numbers the auditor assigned to each audit finding in accordance with §____.510(c).

Subpart E — Auditors

§____.500 Scope of audit.

(a) *General.* The audit shall be conducted in accordance with GAGAS. The audit shall cover the entire operations of the auditee; or, at the option of the auditee, such audit shall include a series of audits that cover departments, agencies, and other organizational units which expended or otherwise administered Federal awards during such fiscal year, provided that each such audit shall encompass the financial statements and schedule of expenditures of Federal awards for each such department, agency, and other organizational unit, which shall be considered to be a non-Federal entity. The financial statements and schedule of expenditures of Federal awards shall be for the same fiscal year.

(b) *Financial statements.* The auditor shall determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles. The auditor shall also determine whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the auditee's financial statements taken as a whole.

(c) *Internal control.* (1) In addition to the requirements of GAGAS, the auditor shall perform procedures to obtain an understanding of internal control over Federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs.

(2) Except as provided in paragraph (c)(3) of this section, the auditor shall:

(i) Plan the testing of internal control over major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program; and

(ii) Perform testing of internal control as planned in paragraph (c)(2)(i) of this section.

(3) When internal control over some or all of the compliance requirements for a major program are likely to be ineffective in preventing or detecting noncompliance, the planning and performing of testing described in paragraph (c)(2) of this section are not required for those compliance requirements. However, the auditor shall report a reportable condition (including whether any such condition is a material weakness) in accordance with §____.510, assess the related control risk at the maximum, and consider whether additional compliance tests are required because of ineffective internal control.

(d) *Compliance.* (1) In addition to the requirements of GAGAS, the auditor shall determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs.

(2) The principal compliance requirements applicable to most Federal programs and the compliance requirements of the largest Federal programs are included in the compliance supplement.

(3) For the compliance requirements related to Federal programs contained in the compliance supplement, an audit of these compliance requirements will meet the requirements of this part. Where there have been changes to the compliance requirements and the changes are not reflected in the compliance supplement, the auditor shall determine the current compliance requirements and modify the audit procedures accordingly. For those Federal programs not covered in the compliance supplement, the auditor should use the types of compliance requirements contained in the compliance supplement as guidance for identifying the types of compliance requirements to test, and determine the requirements governing the Federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements.

(4) The compliance testing shall include tests of transactions and such other auditing procedures necessary to provide the auditor sufficient evidence to support an opinion on compliance.

(e) *Audit follow-up.* The auditor shall follow-up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee in accordance with

§____.315(b), and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor shall perform audit follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year.

(f) *Data Collection Form.* As required in §____.320(b)(3), the auditor shall complete and sign specified sections of the data collection form.

§____.505 Audit reporting.

The auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in this section. The auditor's report(s) shall state that the audit was conducted in accordance with this part and include the following:

(a) An opinion (or disclaimer of opinion) as to whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles and an opinion (or disclaimer of opinion) as to whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole.

(b) A report on internal control related to the financial statements and major programs. This report shall describe the scope of testing of internal control and the results of the tests, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(c) A report on compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements. This report shall also include an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on each major program, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(d) A schedule of findings and questioned costs which shall include the following three components:

(1) A summary of the auditor's results which shall include:

(i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);

(ii) Where applicable, a statement that reportable conditions in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses;

(iii) A statement as to whether the audit disclosed any noncompliance which is material to the financial statements of the auditee;

(iv) Where applicable, a statement that reportable conditions in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses;

(v) The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);

(vi) A statement as to whether the audit disclosed any audit findings which the auditor is required to report under §____.510(a);

(vii) An identification of major programs;

(viii) The dollar threshold used to distinguish between Type A and Type B programs, as described in §____.520(b); and

(ix) A statement as to whether the auditee qualified as a low-risk auditee under §____.530.

(2) Findings relating to the financial statements which are required to be reported in accordance with GAGAS.

(3) Findings and questioned costs for Federal awards which shall include audit findings as defined in §____.510(a).

(i) Audit findings (e.g., internal control findings, compliance findings, questioned costs, or fraud) which relate to the same issue should be presented as a single audit finding. Where practical, audit findings should be organized by Federal agency or pass-through entity.

(ii) Audit findings which relate to both the financial statements and Federal awards, as reported under paragraphs (d)(2) and (d)(3) of this section, respectively, should be reported in both sections of the schedule. However, the reporting in one section of the schedule may be in summary form with a reference to a detailed reporting in the other section of the schedule.

§____.510 Audit findings.

(a) *Audit findings reported.* The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(1) Reportable conditions in internal control over major programs. The auditor's determination of whether a deficiency in internal control is a reportable condition for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the compliance supplement. The auditor shall identify reportable conditions which are individually or cumulatively material weaknesses.

(2) Material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a major program. The auditor's determination of whether a noncompliance with the provisions of laws, regulations, contracts, or grant agreements is material for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the compliance supplement.

(3) Known questioned costs which are greater than $10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor shall also report known questioned costs when likely questioned costs are greater than $10,000 for a type of compliance requirement for a major program. In reporting questioned costs, the auditor shall include information to provide proper perspective for judging the prevalence and consequences of the questioned costs.

(4) Known questioned costs which are greater than $10,000 for a Federal program which is not audited as a major program. Except for audit follow-up, the auditor is not required under this part to perform audit procedures for such a Federal program; therefore, the auditor will normally not find questioned costs for a program which is not audited as a major program. However, if the auditor does become aware of questioned costs for a Federal program which is not audited as a major program (e.g., as part of audit follow-up or other audit procedures) and the known questioned costs are greater than $10,000, then the auditor shall report this as an audit finding.

(5) The circumstances concerning why the auditor's report on compliance for major programs is other than an unqualified opinion, unless such circumstances are otherwise reported as audit findings in the

schedule of findings and questioned costs for Federal awards.

(6) Known fraud affecting a Federal award, unless such fraud is otherwise reported as an audit finding in the schedule of findings and questioned costs for Federal awards. This paragraph does not require the auditor to make an additional reporting when the auditor confirms that the fraud was reported outside of the auditor's reports under the direct reporting requirements of GAGAS.

(7) Instances where the results of audit follow-up procedures disclosed that the summary schedule of prior audit findings prepared by the auditee in accordance with §____.315(b) materially misrepresents the status of any prior audit finding.

(b) *Audit finding detail.* Audit findings shall be presented in sufficient detail for the auditee to prepare a corrective action plan and take corrective action and for Federal agencies and pass-through entities to arrive at a management decision. The following specific information shall be included, as applicable, in audit findings:

(1) Federal program and specific Federal award identification including the CFDA title and number, Federal award number and year, name of Federal agency, and name of the applicable pass-through entity. When information, such as the CFDA title and number or Federal award number, is not available, the auditor shall provide the best information available to describe the Federal award.

(2) The criteria or specific requirement upon which the audit finding is based, including statutory, regulatory, or other citation.

(3) The condition found, including facts that support the deficiency identified in the audit finding.

(4) Identification of questioned costs and how they were computed.

(5) Information to provide proper perspective for judging the prevalence and consequences of the audit findings, such as whether the audit findings represent an isolated instance or a systemic problem. Where appropriate, instances identified shall be related to the universe and the number of cases examined and be quantified in terms of dollar value.

(6) The possible asserted effect to provide sufficient information to the auditee and Federal agency, or pass-through entity in the case of a subrecipient, to permit them to determine the cause and effect to facilitate prompt and proper corrective action.

(7) Recommendations to prevent future occurrences of the deficiency identified in the audit finding.

(8) Views of responsible officials of the auditee when there is disagreement with the audit findings, to the extent practical.

(c) *Reference numbers.* Each audit finding in the schedule of findings and questioned costs shall include a reference number to allow for easy referencing of the audit findings during follow-up.

§____.515 Audit working papers.

(a) *Retention of working papers.* The auditor shall retain working papers and reports for a minimum of three years after the date of issuance of the auditor's report(s) to the auditee, unless the auditor is notified in writing by the cognizant agency for audit, oversight agency for audit, or pass-through entity to extend the retention period. When the auditor is aware that the Federal awarding agency, pass-through entity, or auditee is contesting an audit finding, the auditor shall contact the parties contesting the audit finding for guidance prior to destruction of the working papers and reports.

(b) *Access to working papers.* Audit working papers shall be made available upon request to the cognizant or oversight agency for audit or its designee, a Federal agency providing direct or indirect funding, or GAO at the completion of the audit, as part of a quality review, to resolve audit findings, or to carry out oversight responsibilities consistent with the purposes of this part. Access to working papers includes the right of Federal agencies to obtain copies of working papers, as is reasonable and necessary.

§____.520 Major program determination.

(a) *General.* The auditor shall use a risk-based approach to determine which Federal programs are major programs. This risk-based approach shall include consideration of: Current and prior audit experience, oversight by Federal agencies and pass-through entities, and the inherent risk of the Federal program. The process in paragraphs (b) through (i) of this section shall be followed.

(b) *Step 1.* (1) The auditor shall identify the larger Federal programs, which shall be labeled Type A programs. Type A programs are defined as Federal programs with Federal awards expended during the audit period exceeding the larger of:

(i) $300,000 or three percent (.03) of total Federal awards expended in the case of an auditee for which total Federal awards expended equal or exceed $300,000 but are less than or equal to $100 million.

(ii) $3 million or three-tenths of one percent (.003) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed $100 million but are less than or equal to $10 billion.

(iii) $30 million or 15 hundredths of one percent (.0015) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed $10 billion.

(2) Federal programs not labeled Type A under paragraph (b)(1) of this section shall be labeled Type B programs.

(3) The inclusion of large loan and loan guarantees (loans) should not result in the exclusion of other programs as Type A programs. When a Federal program providing loans significantly affects the number or size of Type A programs, the auditor shall consider this Federal program as a Type A program and exclude its values in determining other Type A programs.

(4) For biennial audits permitted under §____.220, the determination of Type A and Type B programs shall be based upon the Federal awards expended during the two-year period.

(c) *Step 2.* (1) The auditor shall identify Type A programs which are low-risk. For a Type A program to be considered low-risk, it shall have been audited as a major program in at least one of the two most recent audit periods (in the most recent audit period in the case of a biennial audit), and, in the most recent audit period, it shall have had no audit findings under §____.510(a). However, the auditor may use judgment and consider that audit findings from questioned costs under §____.510(a)(3) and §____.510(a)(4), fraud under §____.510(a)(6), and audit follow-up for the summary schedule of prior audit findings under §____.510(a)(7) do not preclude the Type A program from being low-risk. The auditor shall consider: the criteria in §____.525(c), §____.525(d)(1), §____.525(d)(2), and §____.525(d)(3); the results of audit follow-up; whether any changes in personnel or systems affecting a Type A program have significantly increased risk; and apply professional judgment in determining whether a Type A program is low-risk.

(2) Notwithstanding paragraph (c)(1) of this section, OMB may approve a Federal awarding agency's request that a Type A program at certain recipients may not be

considered low-risk. For example, it may be necessary for a large Type A program to be audited as major each year at particular recipients to allow the Federal agency to comply with the Government Management Reform Act of 1994 (31 U.S.C. 3515). The Federal agency shall notify the recipient and, if known, the auditor at least 180 days prior to the end of the fiscal year to be audited of OMB's approval.

(d) *Step 3.* (1) The auditor shall identify Type B programs which are high-risk using professional judgment and the criteria in §____.525. However, should the auditor select Option 2 under Step 4 (paragraph (e)(2)(i)(B) of this section), the auditor is not required to identify more high-risk Type B programs than the number of low-risk Type A programs. Except for known reportable conditions in internal control or compliance problems as discussed in §____.525(b)(1), §____.525(b)(2), and §____.525(c)(1), a single criteria in §____.525 would seldom cause a Type B program to be considered high-risk.

(2) The auditor is not expected to perform risk assessments on relatively small Federal programs. Therefore, the auditor is only required to perform risk assessments on Type B programs that exceed the larger of:

(i) $100,000 or three-tenths of one percent (.003) of total Federal awards expended when the auditee has less than or equal to $100 million in total Federal awards expended.

(ii) $300,000 or three-hundredths of one percent (.0003) of total Federal awards expended when the auditee has more than $100 million in total Federal awards expended.

(e) *Step 4.* At a minimum, the auditor shall audit all of the following as major programs:

(1) All Type A programs, except the auditor may exclude any Type A programs identified as low-risk under Step 2 (paragraph (c)(1) of this section).

(2) (i) High-risk Type B programs as identified under either of the following two options:

(A) *Option 1.* At least one half of the Type B programs identified as high-risk under Step 3 (paragraph (d) of this section), except this paragraph (e)(2)(i)(A) does not require the auditor to audit more high-risk Type B programs than the number of low-risk Type A programs identified as low-risk under Step 2.

(B) *Option 2.* One high-risk Type B program for each Type A program identified as low-risk under Step 2.

(ii) When identifying which high-risk Type B programs to audit as major under either Option 1 or 2 in paragraph (e)(2)(i)(A) or (B) of this section, the auditor is encouraged to use an approach which provides an opportunity for different high-risk Type B programs to be audited as major over a period of time.

(3) Such additional programs as may be necessary to comply with the percentage of coverage rule discussed in paragraph (f) of this section. This paragraph (e)(3) may require the auditor to audit more programs as major than the number of Type A programs.

(f) *Percentage of coverage rule.* The auditor shall audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 50 percent of total Federal awards expended. If the auditee meets the criteria in §____.530 for a low-risk auditee, the auditor need only audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 25 percent of total Federal awards expended.

(g) *Documentation of risk.* The auditor shall document in the working papers the risk analysis process used in determining major programs.

(h) *Auditor's judgment.* When the major program determination was performed and documented in accordance with this part, the auditor's judgment in applying the risk-based approach to determine major programs shall be presumed correct. Challenges by Federal agencies and pass-through entities shall only be for clearly improper use of the guidance in this part. However, Federal agencies and pass-through entities may provide auditors guidance about the risk of a particular Federal program and the auditor shall consider this guidance in determining major programs in audits not yet completed.

(i) *Deviation from use of risk criteria.* For first-year audits, the auditor may elect to determine major programs as all Type A programs plus any Type B programs as necessary to meet the percentage of coverage rule discussed in paragraph (f) of this section. Under this option, the auditor would not be required to perform the procedures discussed in paragraphs (c), (d), and (e) of this section.

(1) A first-year audit is the first year the entity is audited under this part or the first year of a change of auditors.

(2) To ensure that a frequent change of auditors would not preclude audit of high-risk Type B programs, this election for first-year audits may not be used by an auditee more than once in every three years.

§____.525 Criteria for Federal program risk.

(a) *General.* The auditor's determination should be based on an overall evaluation of the risk of noncompliance occurring which could be material to the Federal program. The auditor shall use auditor judgment and consider criteria, such as described in paragraphs (b), (c), and (d) of this section, to identify risk in Federal programs. Also, as part of the risk analysis, the auditor may wish to discuss a particular Federal program with auditee management and the Federal agency or pass-through entity.

(b) *Current and prior audit experience.* (1) Weaknesses in internal control over Federal programs would indicate higher risk. Consideration should be given to the control environment over Federal programs and such factors as the expectation of management's adherence to applicable laws and regulations and the provisions of contracts and grant agreements and the competence and experience of personnel who administer the Federal programs.

(i) A Federal program administered under multiple internal control structures may have higher risk. When assessing risk in a large single audit, the auditor shall consider whether weaknesses are isolated in a single operating unit (e.g., one college campus) or pervasive throughout the entity.

(ii) When significant parts of a Federal program are passed through to subrecipients, a weak system for monitoring subrecipients would indicate higher risk.

(iii) The extent to which computer processing is used to administer Federal programs, as well as the complexity of that processing, should be considered by the auditor in assessing risk. New and recently modified computer systems may also indicate risk.

(2) Prior audit findings would indicate higher risk, particularly when the situations identified in the audit findings could have a significant impact on a Federal program or have not been corrected.

(3) Federal programs not recently audited as major programs may be of higher risk than Federal programs recently audited as major programs without audit findings.

(c) *Oversight exercised by Federal agencies and pass-through entities.* (1) Oversight exercised by Federal agencies or pass-through entities could indicate risk. For example, recent monitoring or other reviews performed by an

oversight entity which disclosed no significant problems would indicate lower risk. However, monitoring which disclosed significant problems would indicate higher risk.

(2) Federal agencies, with the concurrence of OMB, may identify Federal programs which are higher risk. OMB plans to provide this identification in the compliance supplement.

(d) *Inherent risk of the Federal program.* (1) The nature of a Federal program may indicate risk. Consideration should be given to the complexity of the program and the extent to which the Federal program contracts for goods and services. For example, Federal programs that disburse funds through third party contracts or have eligibility criteria may be of higher risk. Federal programs primarily involving staff payroll costs may have a high-risk for time and effort reporting, but otherwise be at low-risk.

(2) The phase of a Federal program in its life cycle at the Federal agency may indicate risk. For example, a new Federal program with new or interim regulations may have higher risk than an established program with time-tested regulations. Also, significant changes in Federal programs, laws, regulations, or the provisions of contracts or grant agreements may increase risk.

(3) The phase of a Federal program in its life cycle at the auditee may indicate risk. For example, during the first and last years that an auditee participates in a Federal program, the risk may be higher due to start-up or closeout of program activities and staff.

(4) Type B programs with larger Federal awards expended would be of higher risk than programs with substantially smaller Federal awards expended.

§____.530 Criteria for a low-risk auditee.

An auditee which meets all of the following conditions for each of the preceding two years (or, in the case of biennial audits, preceding two audit periods) shall qualify as a low-risk auditee and be eligible for reduced audit coverage in accordance with §____.520:

(a) Single audits were performed on an annual basis in accordance with the provisions of this part. A non-Federal entity that has biennial audits does not qualify as a low-risk auditee, unless agreed to in advance by the cognizant or oversight agency for audit.

(b) The auditor's opinions on the financial statements and the schedule of expenditures of Federal awards were unqualified. However, the cognizant or oversight agency for audit may judge that an opinion qualification does not affect the management of Federal awards and provide a waiver.

(c) There were no deficiencies in internal control which were identified as material weaknesses under the requirements of GAGAS. However, the cognizant or oversight agency for audit may judge that any identified material weaknesses do not affect the management of Federal awards and provide a waiver.

(d) None of the Federal programs had audit findings from any of the following in either of the preceding two years (or, in the case of biennial audits, preceding two audit periods) in which they were classified as Type A programs:

(1) Internal control deficiencies which were identified as material weaknesses;

(2) Noncompliance with the provisions of laws, regulations, contracts, or grant agreements which have a material effect on the Type A program; or

(3) Known or likely questioned costs that exceed five percent of the total Federal awards expended for a Type A program during the year.

Appendix A to Part ____ — Data Collection Form (Form SF-SAC)

[insert SF-SAC after finalized]

Appendix B to Part ____ — Circular A-133 Compliance Supplement

Note: Provisional OMB Circular A-133 Compliance Supplement is available from the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503.

INSTRUCTIONS FOR COMPLETION OF SF-SAC, REPORTING ON AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS

According to the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is OMB No. 0348-0057. The time required to complete this data collection form is estimated to average 30 hours for large auditees (i.e., auditees most likely to administer a large number of Federal awards) and 6 hours for all other auditees. These amounts reflect estimates of reporting burden on both auditees and auditors relating to the data collection form, including the time to review instructions, obtain the needed data, and complete and review the information collection.

Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," requires non-Federal entities that expend $300,000 or more in a year in Federal awards to have an audit conducted in accordance with the Circular.

Circular A-133 (§__. 320(b)) requires auditees to submit a data collection form, along with other specified reports, to the Federal clearinghouse designated by OMB (currently the U.S. Bureau of the Census) at the completion of each audit.

SUBMISSION TO FEDERAL CLEARINGHOUSE

The data collection form must be completely filled out and signed by both the auditee and auditor. **Submission of anything other than a complete data collection form and reporting package as required by Circular A-133 will be returned to the auditee.**

DESCRIPTION OF THE DATA COLLECTION FORM ITEMS

PART I - GENERAL INFORMATION

The auditee shall complete this section, except for Item 7, and sign the certification statement provided in Item 6 (g).

- **Item 1 - Fiscal Year Ending Date**

  Enter the last day of the entity's fiscal period covered by the audit.

- **Item 2 - Type of Circular A-133 Audit**

  Check the appropriate box. §__.200 of Circular A-133 requires non-Federal entities that expend $300,000 or more in a year in Federal awards to have a single audit conducted in accordance with §__.500, except when they elect to have a program-specific audit conducted in accordance with §__.235.

- **Item 3 - Audit Period Covered**

  Check the appropriate box. Annual audits cover 12 months and Biennial audits cover 24 months. If the audit period covered is neither Annual nor Biennial, mark "Other" and provide the number of months covered in the space provided.

- **Item 4 - Date Received by Federal Clearinghouse**

  Federal Government use only.

- **Item 5 - Employer Identification Number (EIN)**

  (a) Auditee EIN

  Enter the auditee Employer Identification Number (EIN), which is the Taxpayer Identification Number assigned by the Internal Revenue Service (IRS). Also, using the spaces provided, enter the EIN on the top of each page.

  (b) Multiple EINs Covered in the Report

  Check the appropriate box to indicate whether the auditee (or components of an auditee covered by the audit) was assigned more than one EIN by the IRS. (Example: A State-wide audit covers many departments, each of which may have its own separate EIN.) If yes, indicate principal EIN under 5 (a).

- **Item 6 - Auditee Information**

  (g) A senior representative of the auditee (e.g., State controller, director of finance, chief executive officer, chief financial officer) shall sign a statement that the information in the form is accurate and complete as required by §__.320 of Circular A-133. Provide the name and title of the signatory and date of signature.

- **Item 7 - Auditor Information**

  The auditor shall complete this item.

  (a) Enter the name of the auditor that conducted the audit in accordance with Circular A-133. The auditor name may represent a sole practitioner, certified public accounting firm, State auditor, etc. Where multiple auditors or audit organizations are used to conduct the audit work, the auditors should use judgment in determining which auditor's name should be provided in Item 7. The auditor listed in Part I, Item 7 (a) shall be the same auditor that signs the auditor statement in Part I, Item 7 (g) of this form.

- **Item 8 - Cognizant or Oversight Agency for Audit**

  Check the appropriate box. Each auditee has either a Federal cognizant agency for audit or an oversight agency for audit, determined in accordance with §__.400(a) or (b) of Circular A-133.

- **Item 9 - Name of Federal Cognizant or Oversight Agency for Audit**

  Check the appropriate box to indicate the name of the Federal cognizant or oversight agency for audit determined in accordance with §__.400(a) or (b) of Circular A-133.

PART II - FINANCIAL STATEMENTS

The auditor shall complete this section of the form.

CONTINUED ON REVERSE SIDE

INSTRUCTIONS FOR COMPLETION OF SF-SAC, REPORTING ON AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS – Continued

PART III - FEDERAL PROGRAMS

The auditor shall complete this section of the form.

- **Item 1 – Type of Audit Report on Major Program Compliance**

  If the audit report for one or more major programs is other than unqualified, check boxes 2, 3, or 4, as applicable. For example, if the audit report on major program compliance for an auditee with three major programs includes an unqualified opinion for one program, a qualified opinion for the second program, and a disclaimer of opinion for the third program, then check boxes 2 and 4 but not box 1.

- **Item 2 – Dollar Threshold to Distinguish Type A and Type B Programs**

  Enter the dollar threshold used to distinguish between Type A and Type B programs as defined in §__.520(b) of Circular A-133.

- **Item 3 – Low-Risk Auditee**

  Indicate whether or not the auditee qualifies as a low-risk auditee under §__.530 of Circular A-133.

- **Item 4 – Audit Findings**

  Indicate whether or not the audit disclosed any audit findings which the auditor is required to report under §__.510(a) of Circular A-133.

- **Item 5 – Federal Agencies Required to Receive the Reporting Package**

  Check the appropriate box to indicate each Federal awarding agency required to receive a copy of the reporting package pursuant to §__.320(d) of Circular A-133. If no Federal awarding agency is required to receive a copy of the reporting package, mark "None."

- **Item 6 – Federal Awards Expended**

  The information to complete columns (a), (b), and (c) shall be obtained from the Schedule of Expenditures of Federal Awards prepared by the auditee. It is important to note that Item 6 shall include the required information for each Federal program presented in the Schedule of Expenditures of Federal Awards (and notes thereto), i.e., not only Federal programs for which audit findings and questioned costs are reported. If additional space is required, photocopy page 3 and attach the additional page(s) to the form.

  Column (a) – CFDA Number

  Enter the number assigned to a Federal program in the Catalog of Federal Domestic Assistance (CFDA) or other identifying number when the CFDA information is not available. If the CFDA information is not available, enter the identifying number provided by the Federal awarding agency or pass-through entity. Individual programs within a cluster of programs shall be listed in the same level of detail as they are listed in the Schedule of Expenditures of Federal Awards.

  Column (b) – Name of Federal Program

  Enter the name of the Federal program. If no CFDA number is provided in column (a), enter the name of the Federal program and the Federal awarding agency or pass-through entity that provided the Federal award.

  Column (c) – Amount of Federal Expenditures

  Enter the amount of expenditures included in the Schedule of Expenditures of Federal Awards for each Federal program. It is important to note that amounts shall be provided for the value of Federal awards expended in the form of non-cash assistance, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year end, regardless of whether such amounts were presented in the Schedule of Expenditures of Federal Awards or in a note to the Schedule.

  If additional space is required, photocopy page 3, attach additional page(s) to the form, and enter the total for all pages in the "Total Federal Awards Expended" block on the last page.

- **Item 7– Audit Findings and Questioned Costs**

  The information to complete columns (a), (b), (c), (d) and (e) shall be obtained from the Schedule of Findings and Questioned Costs prepared by the auditor. Audit findings and questioned costs that relate to more than one Federal program shall be presented in the form for each Federal program for which audit findings and questioned costs are reported in the auditor's Schedule of Findings and Questioned Costs. If additional space is required, photocopy page 3 and attach the additional page(s) to the form.

  Column (a) – Major Program

  Indicate whether or not the Federal program is a major program, as defined in §__.520 of Circular A-133.

  Column (b) – Type of Compliance Requirement

  Using the list provided on the form, enter the letter that corresponds to the type(s) of compliance requirements applicable to the audit findings and questioned costs reported for each Federal program. Mark all that apply or "None."

  Column (c) – Questioned Costs

  Enter the amount of reported questioned costs by Federal program. If no questioned costs were reported, enter N/A for "Not Applicable."

  Column (d) – Internal Control Findings

  Check the appropriate box, using the list provided on the form, that corresponds to the internal control findings that apply to the Federal program. Mark all that apply or "None reported."

  Column (e) – Audit Finding Reference Numbers

  Enter the audit finding reference number(s) for audit findings included in the Schedule of Findings and Questioned Costs. If no audit finding reference numbers exist, enter N/A for "Not Applicable."

OMB No. 0348-0057

FORM **SF-SAC**
(8-97)

U.S. DEPARTMENT OF COMMERCE - BUREAU OF THE CENSUS
ACTING AS COLLECTING AGENT FOR
OFFICE OF MANAGEMENT AND BUDGET

Data Collection Form for Reporting on

AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS

▶ Complete this form, as required by OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

RETURN TO **Single Audit Clearinghouse**
1201 E. 10th Street
Jeffersonville, IN 47132

PART I GENERAL INFORMATION *(To be completed by auditee, except for Item 7)*

1. Fiscal year ending date for this submission
Month / Day / Year

2. Type of Circular A-133 audit
1 ☐ Single audit 2 ☐ Program-specific audit

3. Audit period covered
1 ☐ Annual 3 ☐ Other – Months
2 ☐ Biennial

FEDERAL GOVERNMENT USE ONLY

4. Date received by Federal clearinghouse

5. Employer Identification Number (EIN)
a. Auditee EIN ☐☐☐☐☐☐☐☐☐ **b.** Are multiple EINs covered in this report? 1 ☐ Yes 2 ☐ No

6. AUDITEE INFORMATION

a. Auditee name

b. Auditee address *(Number and street)*

City

State ZIP Code

c. Auditee contact
Name

Title

d. Auditee contact telephone
( ) –

e. Auditee contact FAX *(Optional)*
( ) –

f. Auditee contact E-mail *(Optional)*

g. AUDITEE CERTIFICATION STATEMENT – This is to certify that, to the best of my knowledge and belief, the auditee has: (1) Engaged an auditor to perform an audit in accordance with the provisions of OMB Circular A-133 for the period described in Part I, Items 1 and 3; (2) the auditor has completed such audit and presented a signed audit report which states that the audit was conducted in accordance with the provisions of the Circular; and, (3) the information included in **Parts I, II,** and **III** of this data collection form is accurate and complete. I declare that the foregoing is true and correct.

Signature of certifying official Date
Month / Day / Year

Name/Title of certifying official

7. AUDITOR INFORMATION *(To be completed by auditor)*

a. Auditor name

b. Auditor address *(Number and street)*

City

State ZIP Code

c. Auditor contact
Name

Title

d. Auditor contact telephone
( ) –

e. Auditor contact FAX *(Optional)*
( ) –

f. Auditor contact E-mail *(Optional)*

g. AUDITOR STATEMENT – The data elements and information included in this form are limited to those prescribed by OMB Circular A-133. The information included in Parts II and III of the form, except for Part III, Items 5 and 6, was transferred from the auditor's report(s) for the period described in Part I, Items 1 and 3, and is **not a substitute** for such reports. The auditor has not performed any auditing procedures since the date of the auditor's report(s). A copy of the reporting package required by OMB Circular A-133, which includes the complete auditor's report(s), is available in its entirety from the auditee at the address provided in Part I of this form. As required by OMB Circular A-133, the information in **Parts II** and **III** of this form was entered in this form by the auditor based on information included in the reporting package. The auditor has not performed any additional auditing procedures in connection with the completion of this form.

Signature of auditor Date
Month / Day / Year

EIN: | | | | | | | | | |

PART I GENERAL INFORMATION – Continued

8. Indicate whether the auditee has either a Federal cognizant or oversight agency for audit. *(Mark (X) one box)*

1 ☐ Cognizant agency 2 ☐ Oversight agency

9. Name of Federal cognizant or oversight agency for audit *(Mark (X) one box)*

01 ☐ African Development Foundation
02 ☐ Agency for International Development
10 ☐ Agriculture
11 ☐ Commerce
94 ☐ Corporation for National and Community Service
12 ☐ Defense
84 ☐ Education
81 ☐ Energy
66 ☐ Environmental Protection Agency
83 ☐ Federal Emergency Management Agency
34 ☐ Federal Mediation and Conciliation Service
39 ☐ General Services Administration
93 ☐ Health and Human Services
14 ☐ Housing and Urban Development
03 ☐ Institute for Museum Services
04 ☐ Inter-American Foundation
15 ☐ Interior
16 ☐ Justice
17 ☐ Labor
43 ☐ National Aeronautics and Space Administration
89 ☐ National Archives and Records Administraton
05 ☐ National Endowment for the Arts
06 ☐ National Endowment for the Humanities
47 ☐ National Science Foundation
07 ☐ Office of National Drug Control Policy
08 ☐ Peace Corps
59 ☐ Small Business Administration
96 ☐ Social Security Administration
19 ☐ State
20 ☐ Transportation
21 ☐ Treasury
82 ☐ United States Information Agency
64 ☐ Veterans Affairs
☐ Other – *Specify:*

PART II FINANCIAL STATEMENTS *(To be completed by auditor)*

1. Type of audit report *(Mark (X) one box)*

1 ☐ Unqualified opinion 2 ☐ Qualified opinion 3 ☐ Adverse opinion 4 ☐ Disclaimer of opinion

2. Is a "going concern" explanatory paragraph included in the audit report? 1 ☐ Yes 2 ☐ No

3. Is a reportable condition disclosed? 1 ☐ Yes 2 ☐ No – *SKIP to Item 5*

4. Is any reportable condition reported as a material weakness? 1 ☐ Yes 2 ☐ No

5. Is a material noncompliance disclosed? 1 ☐ Yes 2 ☐ No

PART III FEDERAL PROGRAMS *(To be completed by auditor)*

1. Type of audit report on major program compliance

1 ☐ Unqualified opinion 2 ☐ Qualified opinion 3 ☐ Adverse opinion 4 ☐ Disclaimer of opinion

2. What is the dollar threshold to distinguish Type A and Type B programs §___ .520(b)?

$

3. Did the auditee qualify as a low-risk auditee (§___ .530)?

1 ☐ Yes 2 ☐ No

4. Are there any audit findings required to be reported under §___ .510(a)?

1 ☐ Yes 2 ☐ No

5. Which Federal Agencies are required to receive the reporting package? *(Mark (X) all that apply)*

01 ☐ African Development Foundation
02 ☐ Agency for International Development
10 ☐ Agriculture
11 ☐ Commerce
94 ☐ Corporation for National and Community Service
12 ☐ Defense
84 ☐ Education
81 ☐ Energy
66 ☐ Environmental Protection Agency
83 ☐ Federal Emergency Management Agency
34 ☐ Federal Mediation and Conciliation Service
39 ☐ General Services Administration
93 ☐ Health and Human Services
14 ☐ Housing and Urban Development
03 ☐ Institute for Museum Services
04 ☐ Inter-American Foundation
15 ☐ Interior
16 ☐ Justice
17 ☐ Labor
43 ☐ National Aeronautics and Space Administration
89 ☐ National Archives and Records Administraton
05 ☐ National Endowment for the Arts
06 ☐ National Endowment for the Humanities
47 ☐ National Science Foundation
07 ☐ Office of National Drug Control Policy
08 ☐ Peace Corps
59 ☐ Small Business Administration
96 ☐ Social Security Administration
19 ☐ State
20 ☐ Transportation
21 ☐ Treasury
82 ☐ United States Information Agency
64 ☐ Veterans Affairs
00 ☐ None
☐ Other – *Specify:*

FORM SF-SAC (8-97)

EIN: ☐☐☐☐☐☐☐☐☐

FORM SF-SAC (8-97)

PART III FEDERAL PROGRAMS – Continued

6. FEDERAL AWARDS EXPENDED DURING FISCAL YEAR			7. AUDIT FINDINGS AND QUESTIONED COSTS				
CFDA number [1] (a)	Name of Federal program (b)	Amount expended (c)	Major program (a)	Type of compliance requirement [2] (b)	Amount of questioned costs (c)	Internal control findings [3] (d)	Audit finding reference number(s) (e)
		$	1☐Yes 2☐No		$	1☐A 3☐C 2☐B	
		$	1☐Yes 2☐No		$	1☐A 3☐C 2☐B	
		$	1☐Yes 2☐No		$	1☐A 3☐C 2☐B	
		$	1☐Yes 2☐No		$	1☐A 3☐C 2☐B	
		$	1☐Yes 2☐No		$	1☐A 3☐C 2☐B	
		$	1☐Yes 2☐No		$	1☐A 3☐C 2☐B	
		$	1☐Yes 2☐No		$	1☐A 3☐C 2☐B	
		$	1☐Yes 2☐No		$	1☐A 3☐C 2☐B	
		$	1☐Yes 2☐No		$	1☐A 3☐C 2☐B	
		$	1☐Yes 2☐No		$	1☐A 3☐C 2☐B	
TOTAL FEDERAL AWARDS EXPENDED →		$	*IF ADDITIONAL LINES ARE NEEDED, PLEASE PHOTOCOPY THIS PAGE, ATTACH ADDITIONAL PAGES TO THE FORM, AND SEE INSTRUCTIONS*				

[1] Or other identifying number when the Catalog of Federal Domestic Assistance (CFDA) number is not available.

[2] Type of compliance requirement *(Enter the letter(s) of all that apply to audit findings and questioned costs reported for each Federal program.)*

A. Activities allowed or unallowed
B. Allowable costs/cost principles
C. Cash management
D. Davis - Bacon Act
E. Eligibility
F. Equipment and real property management
G. Matching, level of effort, earmarking
H. Period of availability of funds
I. Procurement
J. Program income
K. Real property acquisition and relocation assistance
L. Reporting
M. Subrecipient monitoring
N. Special tests and provisions
O. None

[3] Type of internal control findings *(Mark (X) all that apply)*

A. Material weaknesses B. Reportable conditions C. None reported

The next page is: page 23, ¶1103.

¶1103 Office of Management and Budget Circular A-50 (9/29/82)

OFFICE OF MANAGEMENT AND BUDGET (OMB)

Circular A-50 Revised

September 29, 1982

To the Heads of Executive Departments and Establishments

Subject: Audit Followup

1. *Purpose.* This circular provides the policies and procedures for use by executive agencies when considering reports issued by the Inspectors General (IGs), other executive branch audit organizations, the General Accounting Office (GAO), and non-Federal auditors where followup is necessary.

2. *Rescissions.* This revision replaces and rescinds Circular No. A-50, "Executive branch action on General Accounting Office reports," Revised, dated January 15, 1979, and incorporates certain provisions previously set forth in Circular A-73, "Audit of Federal operations and programs," Revised, dated November 27, 1979.

3. *Authority.*

a. Budget and Accounting Act of 1921, as amended (31 USC 16 & 53).

b. Section 236 of the Legislative Reorganization Act of 1970.

c. Supplemental Appropriations and Rescissions Act of 1980 (P.L. 96-304).

d. Appropriations Act of 1981 (P.L. 96-526).

e. 4 CFR 101-105, Federal Claims Collection Standards.

f. GAO Policy and Procedures Manual for Guidance of Federal Agencies (Title 2-Accounting).

4. *Background.* The principal objectives of this revision are:

a. To specify the role of the designated audit followup officials, and the role of Inspectors General with regard to audit followup.

b. To strengthen the procedures for resolution of audit findings and corrective action on recommendations contained in audit reports issued by IGs, other audit organizations, and the GAO.

c. To clarify the applicability of the Circular to regulatory and preaward audits.

d. To emphasize the importance of monitoring the implementation of resolved audit recommendations in order to assure that promised corrective action is actually taken.

e. To improve accounting and collection controls over amounts due the Government as a result of claims arising from audits.

5. *Policy.* Audit followup is an integral part of good management, and is a shared responsibility of agency management officials and auditors. Corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations. Each agency shall establish systems to assure the prompt and proper resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and non-monetary findings and recommendations.

6. *Definitions.*

a. *Responses to Audit Reports* — Written comments by agency officials indicating agreement or disagreement on reported findings and recommendations. Comments indicating agreement on final reports shall include planned corrective actions and, where appropriate, dates for achieving actions. Comments indicating disagreement shall explain fully the reasons for disagreement. Where disagreement is based on interpretation of law, regulation, or the authority of officials to take or not to take action, the response must include the legal basis.

b. *Resolution.*

(1) For most audits, the point at which the audit organization and agency management or contracting officials agree on action to be taken on reported findings and recommendations; or, in the event of disagreement, the point at which the audit followup official determines the matter to be resolved. A report may be considered resolved despite the right of persons outside the agency to negotiate, appeal, or litigate. Resolution of a report with respect to parties outside the Government does not preclude further consideration of issues in the report by agency management.

(2) For preaward contract audits, the point at which the agreement is reached, a contract price negotiated, or proposed award canceled, whichever occurs first.

(3) For GAO reports, the point at which the agency responds to the Congress, as required by the Legislative Reorganization Act of 1970.

c. *Corrective Action* — Measures taken to implement resolved audit findings and recommendations.

d. *Disallowed Costs* — An incurred cost questioned by the audit organization that management has agreed should not be charged to the Government.

7. *Responsibilities.*

a. *Agency Head.* Agency heads are responsible for:

(1) Designating a top management official to oversee audit followup, including resolution and corrective action.

(2) Assuring that management officials throughout the agency understand the value of the audit process and are responsive to audit recommendations.

b. *Management Officials.* Agency management officials are responsible for receiving and analyzing audit reports, providing timely responses to the audit organization, and taking corrective action where appropriate. Where management officials disagree with an audit recommendation, the matter shall be resolved by the followup official.

c. *Audit Followup Official.* The audit followup official has personal responsibility for ensuring that (1) systems of audit followup, resolution, and corrective action are documented and in place, (2) timely responses are made to all audit reports, (3) disagreements are resolved, (4) corrective actions are actually taken, and (5) semiannual reports required by paragraph 8.a.(8) below are sent to the head of the agency.

d. *Inspectors General.* Inspectors General or other audit officials are responsible for (1) making independent audits and investigations of their agencies' programs, operations, activities, and functions; (2) overseeing the work of non-Federal auditors performed in connection with Federal programs; and (3) reviewing responses to audit reports and reporting significant disagreements to the audit followup official.

e. *Comptroller General.* The Comptroller General is the head of the GAO, a legislative branch agency responsible for auditing and evaluating programs, activities, and financial operations of the executive branch.

8. *Action Requirements.*

a. *Follow-up Systems.* Agencies shall assign a high priority to the resolution of audit recommendations and to corrective action. Systems for resolution and corrective action must meet the following standards:

(1) Provide for appointment of a top level audit followup official.

(2) Require prompt resolution and corrective actions on audit recommendations. Resolution shall be made within a maximum of six months after issuance of a final report or, in the case of audits performed by non-Federal auditors, six months after receipt of the report by the Federal Government. Corrective action should proceed as rapidly as possible.

(3) Specify criteria for proper resolution and corrective action on audit recommendations, whether resolution is in favor of the

auditor or an auditee. These criteria should provide for written plans for corrective action with specified action dates, where appropriate.

(4) Maintain accurate records of the status of audit reports or recommendations through the entire process of resolution and corrective action. Such records shall include appropriate accounting and collection controls over amounts determined to be due to the Government.

(5) Provide a means to assure timely responses to audit reports and to resolve major disagreements between the audit organization and agency management or contracting officials. The process should provide sufficient time to permit resolution to take place within the six month limit.

(6) Assure that resolution actions are consistent with law, regulation, and Administration policy; and include written justification containing, when applicable, the legal basis for decisions not agreeing with the audit recommendation.

(7) Provide for coordinating resolution and corrective action on recommendations involving more than one program, agency, or level of Government.

(8) Provide semi-annual reports to the agency head on the status of all unresolved audit reports over six months old, the reasons therefor, and a timetable for their resolution; the number of reports or recommendations resolved during the period; the amount of disallowed costs; and collections, offsets, write-offs, demands for payment and other monetary benefits resulting from audits. These reports should include an update on the status of previously reported unresolved audits.

(9) Provide for periodic analysis of audit recommendations, resolution, and corrective action, to determine trends and system-wide problems, and to recommend solutions.

(10) Assure that performance appraisals of appropriate officials reflect effectiveness in resolving and implementing audit recommendations.

(11) Provide for an evaluation of whether the audit followup system results in efficient, prompt, and proper resolution and corrective action on audit recommendations. The first evaluation will be made within one year of the date of this Circular, and evaluations will be made periodically thereafter.

b. *Special Requirements*. The following additional requirements apply to General Accounting Office reports:

(1) *Draft Reports*. The GAO normally issues draft reports to agencies for their review and comment, so that final reports may incorporate agency views. In accordance with 31 USC 53(f)(1), agencies shall provide comments on draft GAO reports with 30 days of issuance. However, the law provides that, if an agency cannot respond to a report within 30 days, the agency may request additional time from GAO to comment.

(2) *Final Reports*. The GAO issues final reports to the Congress or the head of an agency. Agencies are required to respond to these reports in accordance with instructions contained in paragraphs (3) and (4) below.

(3) *Statements to the Office of Management and Budget*. The agency head will submit a statement to the Director of OMB within 60 calendar days after formal transmittal of a GAO report to the agency when at least one of the following applies:

(a) The report contains a specific recommendation for the head of the agency;

(b) The report contains financial statements accompanied by either a qualified audit opinion or a disclaimer of opinion;

(c) The report indicates a violation of the Antideficiency Act which has not been reported to the appropriate authorities;

(d) The report indicates a violation of other laws; or

(e) When requested to comment by OMB.

The agency statement should identify the GAO report by number and date (i.e., GAO/GGD-82-00, dated January 30, 1982), and be submitted in duplicate. It should inform the OMB of the agency views on the findings and recommendations made by the GAO. It should also identify any action taken, or planned, in response to each significant finding or recommendation.

If the agency response to a draft GAO report accurately and adequately reflects its current views, a copy of those comments will be sufficient.

When corrective action is incomplete, still under study, or planned, the agency will include a statement of when it expects action to be completed, and will report on corrective action after it is completed.

The agency should include in its statement to OMB copies of statements required by Section 236 of the Legislative Reorganization Act of 1970. See paragraph (4) below. These statements may be used to satisfy the initial reporting requirements to OMB. The statements should be accompanied by any additional information not provided to the Congress, but required by this section of the Circular.

(4) *Statements to Congressional Committees*. In accordance with Section 236 of the Legislative Reorganization Act of 1970, when a GAO report contains recommendations to the head of an agency, the agency shall:

(a) Submit a written statement to the Senate Committee on Governmental Affairs and the House Committee on Government Operations, no later than 60 days after the date of such report. This statement will report the action taken or to be taken by the agency with respect to the recommendations to the head of the agency.

(b) Submit a written statement to the Committees on Appropriations of the Senate and the House of Representatives, in connection with the first request for appropriations for that agency submitted to the Congress more than sixty days after the date of the GAO report. This statement will report the action taken by the agency with respect to the recommendations to the head of the agency.

Two copies of the above statements will be submitted on the same date to the OMB and the GAO.

(5) *Advance Clearance and/or Coordination Requirements*. Agency statements to Congressional committees, individual Members of Congress or the GAO, will be subject to advance coordination and/or clearance by OMB when the statement:

(1) Expresses views on proposed or pending legislation. See Circular A-19, "Legislative coordination and clearance."

(2) Deals with other agencies, or with executive branch budget policies.

Requests for advance clearance and/or coordination will be addressed to the Director, OMB, and will be forwarded in duplicate. Clearance action will be completed prior to transmittal of the statement.

9. *Applicability to Regulatory Audits*. The requirements for resolution and corrective action contained paragraph 8.a. shall be applied to those reports of agency units responsible for regulatory or inspection activities involving the review of financial matters that may result in:

(a) Fines or penalties;

(b) Assessments or price adjustments; or

(c) Other monetary recoveries by the Government.

The agency audit followup official shall ensure that appropriate followup systems are in place for these units. Separate subsystems may be used.

10. *Applicability to Preaward Contract Audits*. Audit reports involving recommendations on contractor estimates of future costs are subject to the provisions of this

Circular. However, since such reports generally are resolved by negotiation of a contract price, they are not subject to the time limits or reporting requirements set forth in paragraphs 8.a.(2), (5), and (8). The requirement for records on the status of reports set forth in paragraph 8.a.(4) may be met by records maintained in official contract files.

11. *Accounting and Collection Controls.* In order to ensure effective recovery action, each agency will establish accounting and collection controls for amounts due the Government as a result of resolved audit findings and recommendations. Unless otherwise required by statute, all claims arising from audit disallowances shall be collected in accordance with Federal Claims Collection Standards.

a. *Recording Receivables.* Amounts due the Government shall be recorded promptly as accounts receivable on the completion of the acts which entitle an agency to collect such amounts. For example, on matters where the auditor has the authority to make final determinations, such determinations are to be recorded as receivables at the time the audit report is issued. Audit recommendations that are subject to management concurrence will be recorded as accounts receivable within 30 days of being resolved. The recording of the receivable is to be accomplished even though the decision to collect is subject to administrative appeal or litigation by persons outside the agency.

b. *Interest Charges.* Interest on audit-related debts shall begin to accrue no later than 30 days from the date the auditee is notified of the debt. To discourage unwarranted appeals, interest shall continue to accrue while the appeal is underway. The interest rate applied shall be that prescribed by the *Treasury Fiscal Requirements Manual* (1 TFRM 6-8000).

c. *Allowance for Uncollectable Amounts.* Consideration shall be given to the potential for collecting audit-related debts. An allowance account shall be established to reflect that amount of receivables estimated to be uncollectable.

d. *Payment of Debts.* Procedures should be established to assure that the payment of audit-related debts does not result in charges to other Federal programs or in a reduced level of program activity.

e. *Exception.* There may be instances where a portion of the funds on a grant, contract, or other agreement are held back: (1) as a safeguard against overpayment; (2) pending completion, final inspection or approval of work; or (3) in accordance with other provisions of a grant or contract. In such instances, it is not necessary to record a receivable, since disallowed costs may be offset against undisbursed funds in the grant or contract audited.

12. *OMB Responsibility.* OMB will continue to work with agency audit followup officials and Inspectors General to ensure that the provisions of this Circular are implemented.

13. *Information Contact.* Inquiries should be directed to the OMB Financial Management Division at 395-3993 or to the OMB Debt Collection Staff at 395-3967.

14. *Sunset Review Date.* This Circular shall have an independent policy review to ascertain its effectiveness three years from the date of issue.

The next page is: page 27, ¶1104.